SMALL BUSINESS ADMINISTRATION'S BUDGET REQUEST

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

WASHINGTON, DC, MAY 19 AND 27, 1993

Printed for the use of the Committee on Small Business

Serial No. 103–14

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SBA'S BUDGET PRIORITIES

WEDNESDAY, MAY 19, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 10:52 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee), presiding.

Chairman LAFALCE. The Small Business Committee will come to order.

First, I would like to apologize for being late, but we discovered this morning that not only was President Clinton coming to the Democratic Caucus, but that he would not be coming at the beginning of the Democratic Caucus, 8:15, as I originally thought; he would be coming at 9:30, and it did not conclude until about 10 minutes or so ago. So it was a question of meeting with you or the President, Mr. Bowles.

Mr. BOWLES. You made a good choice.

Chairman LAFALCE. We had a tough, tough time on it, but we made that decision. I hope everyone was notified as early this morning as was possible. So, sorry to inconvenience the Administrator and Members of the minority, but I am sure you understand.

Because of that my staff has prepared an absolutely brilliant opening statement. If nobody objects, I would simply insert it in the record as if read, and dispense with reading it.

[Chairman LaFalce's statement may be found in the appendix.]

Chairman LAFALCE. Mr. Bowles, this is your maiden voyage before the Small Business Committee. Based upon the conversations that I have had with you and your record, I certainly believe, and I say this very sincerely, that you have the capacity to be the finest Administrator of the SBA in the history of the agency, As chairman of this committee, I look forward to working with you to help make sure that comes about, and I think it is going to come about. We are delighted to have you here this morning.

I now call upon the ranking minority member, Mrs. Meyers, for any statement she wants to make. I hope at least the Members of my side of the aisle will emulate my outstanding leadership in not reading my opening statement.

[Laughter.]

Chairman LAFALCE. Mrs. Meyers.

Mrs. MEYERS. Mr. Chairman, I will make just a few comments, and I would like to thank you for asking our new Administrator, Erskine Bowles, to come before the committee and testify on the SBA's fiscal year 1994 budget request. I think it is fair to say that

Mr. Bowles has had a whirlwind 1½ weeks on the job, my having crossed paths with him a few times, quite a few times, last week during the Small Business Week activities. Now he is here to explain and to defend his agency's budget request as well as discuss any overall goals he has developed for the SBA. Frankly, I think he deserves our admiration for the way he has hit the ground running in his new position, and I really look forward to working with him.

Mr. Chairman, I must say, having looked over the summary of the SBA's proposal and spent some time yesterday with Larry Rosenbaum, who did a tremendous job in helping us decipher this SBA budget, and with Kris Swedin. If members do not understand the budget proposals, we certainly cannot defend them; not to the Appropriations Committee, not to the Rotary Club back home. We need what I call a real kindergarten explanation of this budget, and of the programs.

I think one of the things that has made talking about the SBA budget difficult is that in other agencies what they are doing with the money, sometimes you can see it. It is much more easy to understand. But, trying to explain an SBIC, or an SBDC, or a CDC, or an SBI to people, and the difference in all of those programs is very difficult, and the mechanics, the financial mechanics of all of those are difficult. We have got to have a really good understanding on this committee.

Some of your proposals, most notably the decrease in the guarantee level for the 7(a) Program, have been part of other administrations' budget requests for the SBA. Others may not be as familiar to Members. This hearing is the beginning of what I hope will be an extensive dialog on SBA Programs, their functions, and their funding levels.

While our Administrator has been on the job a grand total of about 8 days, I hope that today or in the near future this committee can have an opportunity to discuss some long-term goals for the agency. Many of us are very impressed with your background in small business finance and look forward to hearing your suggestions for making the SBA function more efficiently. I am very pleased that you are here today, Administrator Bowles.

Thank you very much, Mr. Chairman, for calling this hearing.

[Mrs. Meyers' statement may be found in the appendix.]

Chairman LaFalce. Thank you. After the chairman and ranking minority member, I think we ought next to ask if there are any individuals from North Carolina who would like to be heard from this morning.

Mr. Lancaster. Mr. Chairman, I——

Chairman LaFalce. Mr. Lancaster.

Mr. Lancaster. I will be very brief, and with her permission, will speak for Mrs. Clayton as well.

We North Carolinians welcome who I agree with you, Mr. Chairman, is going to be the best Administrator in the SBA's history. We look forward to working with him, and this committee, as he carries out the responsibilities he has been given by the President.

Welcome, Mr. Bowles.

Mr. Bowles. Thank you.

Chairman LaFalce. Thank you.

Mrs. Clayton.

Mrs. CLAYTON. He said it well. We will have an opportunity to question him.

Chairman LAFALCE. All right. The former chairman of the Small Business Committee is still a member of the committee, and he is also the chairman of the Appropriations Subcommittee which has a bit of a voice over the future of the SBA also, Mr. Neal Smith, from Iowa.

Mr. SMITH. I just want to welcome the new director of SBA and say I really look forward to working with you, because I think you have the right background, and I am anxious to see you in your new job.

Chairman LAFALCE. We also have, Mr. Bowles, a representative from New Hampshire who worked quite closely with your predecessor and trying to be of special assistance to New Hampshire plights and their serious credit crunch problems. I know he is very interested in that and others matters. Mr. Zeliff.

Mr. ZELIFF. Thank you, Mr. Chairman.

Administrator Bowles, I, as I told you one on one, wish you well.

Mr. BOWLES. Thank you.

Mr. ZELIFF. This is one Republican that is very impressed with your background, and I am sure there are others as well. But I have heard nothing but really good things about you, your commitment, and the great things that we can look forward to. So looking forward to working with you. Obviously, the budget is a good place to start, and I would ask unanimous consent to put my whole statement in the record.

Chairman LAFALCE. Without objection, so ordered.

[Mr. Zeliff's statement may be found in the appendix.]

Mrs. MEYERS. Mr. Chairman, I would ask unanimous consent to put the statements of Jim Ramstad and Ron Machtley in the record.

Chairman LAFALCE. Without objection, so ordered.

[Mr. Ramstad's and Mr. Machtley's statements may be found in the appendix.]

Mrs. CLAYTON. Mr. Chairman, may I also enter my statement in the record, since I did not read it into the record.

[Mrs. Clayton's statement may be found in the appendix.]

Chairman LAFALCE. Everyone who has an opening statement will have it entered as if it were read. Thank you very much.

Welcome, Mr. Bowles. The floor is yours.

Mr. BOWLES. Thank you.

Chairman LAFALCE. Please proceed.

TESTIMONY OF ERSKINE B. BOWLES, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Mr. BOWLES. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I do appreciate this opportunity to appear before you today. Accompanying me is Larry Rosenbaum, who is the Comptroller of our agency.

Chairman LAFALCE. Mr. Bowles, so that we might get to know the other members of the SBA, I wonder if the other members of the SBA who are here would raise their hand and perhaps be identified either by you or by themselves by name and position.

Ms. SWEDIN. I am Kris Swedin. I work in the Office of Congressional Legislative Affairs.

Mr. WHITMORE. I am John Whitmore, Chief Financial Officer.

Chairman LAFALCE. That is it?

All right, thank you.

Mr. BOWLES. Thank you, sir.

I am very excited to be serving as the new Administrator of the SBA. As Mrs. Meyers said just a few minutes ago, I am very new, having only been on the job for 10 days. However, what excites me about this job is it truly gives me that unique opportunity to both serve my country and utilize the business skills I have worked so long and hard to establish over the last 24 years.

I would like to first talk to you briefly about my vision for the SBA.

My vision for the SBA truly reflects the President's vision for small business. This President fully understands the absolutely critical role that small business plays in our economy. Let there be no question in your mind that President Clinton is determined to do whatever is necessary to help small business create the jobs this economy must have to move forward again.

President Clinton has set four priorities for me as head of the Small Business Administration. I want you to know what they are, because I want to be held accountable.

First, we must do our part to end the credit crunch. We must find ways to free up capital for investment in small businesses. Small businesses are starved for capital. You know it, I know it, and the President knows it.

President Clinton, I believe, has already taken a giant step forward in this regard by removing the unnecessary and costly restrictions on banks that prevent them from making character loans. But we must do more. Small businesses cannot grow and cannot create jobs without capital. It is as simple as that. With your help, we are going to do something about it.

Second, we must get rid of the unnecessary paperwork and bureaucratic regulations that inhibit both the growth and productivity of small business. Government regulations have a disproportionately adverse effect on small businesses. The President wants me to attack this issue head-on, and I promise you that is exactly what I am going to do.

Third, we must restructure, reorganize, and reinvigorate the SBA so that it operates in a more efficient, effective manner, and so that it truly serves our customers, and customer is a word that I do not use lightly. Our customers are the men and women who own and operate small businesses throughout this country.

Finally, the President wants the SBA to be his eyes and ears in the small business community. I promise you the SBA will be just that. I think Congresswoman Meyers saw last week the President's commitment to small business. I think you were at most of the functions we had. We had the President come in twice. We had the Vice President come in once. We had two members of the Cabinet come in. This President is committed to small business and committed to the SBA.

I have promised the President that the SBA will serve as his listening post, hearing the concerns and ideas of small business. I, in

turn, plan to report these concerns directly to the President, thereby ensuring that small business has a place at the economic table in the Clinton administration.

My vision for the SBA truly reflects my business background. It reflects a leaner, more efficient, more effective organization that is focused—focused on meeting the needs of small business. My vision also reflects an organization that champions—and I want to stress that word "champions"—champions the needs of small business at the highest levels of Government, guaranteeing small business a place at the economic table.

I am very pleased that I will have a chance to work with and learn from the members of this committee and your staffs.

Mr. Chairman, with your permission, I would now like to give an abbreviated version of my longer statement which I will submit for the record. Thank you.

As you all well know, we have a shortfall in our 1993 7(a) Program. Our funds ran out on April 27, 1993. The administration supports the House Appropriation Committee's supplemental appropriation bill for $181 million in loan subsidy authority to support the 7(a) Program, a program that totals $3.3 billion.

Mr. Chairman, I understand this bill may come before you in the not too distant future. When it does I look forward to working with you for its passage.

Now I would like to highlight the most significant proposals of our fiscal year 1994 budget request.

Chairman LaFalce. I would be remiss if we did not give special thanks to Chairman Neal Smith. I have worked with him to try to get not only the $141 million, but the $181 million, and there is no question we would not have been successful unless he were able to do it as Chairman of the Subcommittee on Appropriations.

Mr. Smith. Thank you for those kind words, but I also want to take this opportunity to say that it has been sort of a bipartisan thing, because this involves 325,000 jobs. We hear a lot of people talking about jobs. They say a program is going to cost $1 or $2 billion, but when you ask how many jobs it will produce, they will say 50,000. We are talking about 325,000 jobs.

Mr. Bowles. It is clearly important, and the administration is 100 percent behind it. Thank you for your support.

Chairman LaFalce. In a sense, the defeat of the stimulus package has helped us up the ante. We are getting $40 million more.

Mr. Bowles. It clearly is the amount we need.

Chairman LaFalce. Yes.

Mr. Bowles. First, as we talk about the 1994 budget, and when I say 1994, I am always referring to fiscal 1994. First, in our 7(a) Program, the proposed policy initiatives that we are requesting will provide the funding necessary to both meet anticipated demand and reduce subsidy cost in our 7(a) Program.

In order to do our part to reduce the massive Federal deficit, we have included two significant savings initiatives for fiscal 1994 through 1998.

The first savings initiative would reduce the Federal guarantee on loans from an average of 81 percent to an average of 75 percent. This means that lenders participating in the 7(a) Program will be required to assume a greater share of the risk. This initiative will

save the taxpayers about $102 million in 1994 alone, and $437 million over the next 4 years.

The second savings initiative involves the secondary market. Approximately half of all 7(a) loans are currently sold in the secondary market. We are proposing an ongoing fee of one-half of one percent per year on the unpaid guaranteed principal balance of all secondary market sales. This initiative will save the taxpayers about $67 million in 1994, and $287 million over the next 4 years.

For the 7(a) Program, SBA will request $154.8 million in loan subsidy authority to support a total program of $6.6 billion in guarantee authority. That is the beauty of the leverage of the program—$154.8 million to support $6.6 billion in guarantee authority. This will ensure that credit worthy small businesses that have previously been denied credit by their banks shall have access to capital.

In 1994, SBA will make approximately 26,000 general business loans to small companies. These loans will create or maintain more than 600,000 jobs during the next 4 years.

The 7(a) Program provides about 90 percent of our total business lending. Our two savings initiatives for the 7(a) Program will save the taxpayers approximately $169 million in fiscal year 1994, and $724 million over the next 4 years.

As you are aware, Mr. Chairman, the SBA's disaster program has provided a valuable service through the years, and we are very proud of this program. However, the realities of a budget deficit situation requires to make certain judgments. In this regard, I would like to discuss some changes we propose for the disaster loan program.

We propose to reduce the disaster loan program's deep subsidy by increasing the interest rate on these loans from 4 percent to the Treasury rate, plus 1 percent. If this initiative is adopted, we estimate that it will cost us only $49.9 million in loan subsidy authority to support a $390 million disaster loan program. We estimate this change in interest rates will save the taxpayers $58 million on a program level of $390 million. During the next 4 years, we estimate that we will save the taxpayers over $245 million.

In summary, the total budget authority request for business and disaster credit programs is for credit subsidies of $263 million to support programs totaling almost $8.2 billion of a small business community. In addition, the proposed savings initiatives will reduce the cost of our credit programs by $227 million in fiscal year 1994, and $969 million over the next 4 years; almost a billion dollars.

Now I would like to make some brief comments on our business development and noncredit programs.

The administration's budget request provides for funding for those authorized programs that provide business development assistance to the small business community. These programs include such areas as our SBDC Program, our tree planting program, the SCORE Program, the SBI Program, the PASS Program, or 7(j) technical assistance program and the various small business outreach programs are all requested to be funded at the same level they were funded in fiscal 1993.

In addition, this request includes funding for the White House Conference on Small Business for fiscal year 1994.

Finally, our request for noncredit programs excludes funding of all unauthorized projects that were earmarked in last year's Appropriation Act. We estimate that this would save the taxpayers $20 million in fiscal year 1994, and $107 million over the next 4 years.

Mr. Chairman, we have also forecasted a reduction in employment in each department of the agency, reducing total full-time equivalents by 59 positions. That excludes disaster assistance and the Inspector General's office, which are forecasted to be reduced by 818 and 2 full-time equivalents, respectively.

Operating costs of the Small Business Administration are also forecasted to be reduced in fiscal 1994 by a total of $2.6 million.

In order to support the administration's efforts to stimulate the economy through the small business sector and to address the urgent need to reduce the cost of Federal programs for fiscal year 1994, we are requesting total budget authority of $693 million—17 percent below the $835 million appropriated for fiscal year 1993. If you included proposed House supplemental appropriation for 7(a) loans of $181 million, our fiscal year 1994 request would be 32 percent below the $1,016 million appropriated for fiscal 1993.

This concludes my summary of the testimony. I will be happy to answer any questions the committee may have.

[Mr. Bowles' statement may be found in the appendix.]

Chairman LaFalce. Thank you very much for your testimony. I will defer my many questions until the other members have had an opportunity to ask theirs, and I will apply rather rigidly the 5-minute rule so that we can give everyone an opportunity.

Mr. Smith.

Mr. Smith. I thank you for your statement. It is no news to you that we have a real budget problem.

Mr. Bowles. Yes, sir.

Mr. Smith. Just take the disaster program alone; it is wishful thinking to believe that there will only be $390 million needed for disaster loans. I do not know what the need will be. If I did, I would not be here. I would be sitting up somewhere else. But there will be disasters. One thing I wanted to bring to your attention is the destruction of the revolving loan concept.

It operated very well for many years. As the loan payments came back in, they were used to fund new loans. These recycled funds were very important because Congress might not even be in session when a disaster occurs and loan money was needed.

In the 1990 agreement at Andrews, they took away the opportunity to use those loan payments as they came back in. You had to get an appropriation each time. That ought to be changed. This particular program needs to use the loan payments as they come back in, and we are going to get a lot of the payments back in, and we have to find some way to get an offset in the appropriation to take care of it.

Chairman LaFalce. Let me just underscore the import of what Mr. Smith has said. That is a very important thing. When you take it up with OMB, it is an asinine way to do business. I mean, if we could just take the money that comes in and use it to make new

disaster loans, we would not have to be running around willy-nilly every single year as we do at the last minute, always coming in late with appropriations.

Mr. SMITH. It is just one of those things that probably was done only in order to appear to be doing something. It should not have been done. It just should not have been done. That is one assignment that I think you need to take on.

Another one is I wish you would take another look at this new tax bill— the expensing provisions. Small businesses use used machinery. If you start a new business, you do not buy new machinery. You try to get by the cheapest you can on investments and that necessitates the purchase of used equipment. I am going to support the tax bill, but I think there are ways, small ways, that small business could be treated better.

A third one I just want to mention to you that I think you ought to really be working on is the graduated tax on corporations. It is hardly graduated when you reach the top bracket at $75,000. One percent in the highest corporate rate produces $16 billion in revenue. A 1-percent rate variation would offset the revenue loss of a graduated tax up to $300,000 before you reach the top bracket. That is something that would help small businesses a lot more than expensing, for that matter.

Now that you are sitting on these councils within the cabinet, these are three things that I wish you would take up as soon as you can. There are a lot of others that you know about. But these are three things that I think would help us a great deal.

Mr. BOWLES. Thank you, Mr. Smith. If I can address those in some kind of order.

I, too, asked about the $390 million, and I have been told that that was the average amount of disasters we have had over each of the last 10 years, the average amount, and that is why the amount that is in the budget for 1994, I think that is what we have to do under the current credit reform law. But, however, I will be delighted to check on that.

I also accept your premise that most small businesses do buy used machinery, and that is something we are discussing now.

Third, I understand what you say about the graduated tax.

Chairman LAFALCE. Mrs. Meyers.

Mrs. MEYERS. Can you tell me, I think I have got it in front of me, what was the total figure that the SBA spent, actually spent in 1992, and what is your best estimate for 1993, and then the total amount that you are requesting for 1994, so that we can get a comparison of those 3 years?

Mr. BOWLES. These are budget authority numbers. In FY 1992, $1.652 million. In 1993, $835 million. In FY 1994, $693 million. The $835 million, of course, excludes $181 million that is before you now.

Mrs. MEYERS. Right. So the $835 excludes?

Mr. BOWLES. Yes, the $835 million excludes.

Mrs. MEYERS. Excludes the——

Mr. BOWLES. So that figure comes up to $1.16 billion, when you add the $181 million.

Mrs. MEYERS. The $1.652 billion is an actual expenditure or is that budget authority, or I am looking for actuals?

Mr. BOWLES. It is budget authority.

Mrs. MEYERS. That is budget authority.

Do we have an actual expenditure?

Mr. BOWLES. In terms of outlays, 1992 would be $858 million.

Mrs. MEYERS. OK.

Mr. BOWLES. 1993 estimate would be about $1.056 billion, excluding the supplemental. Then 1994 is estimated at $972 million. These figures are in terms of outlays. Cash out the door.

As an example, the $181 that we are asking for now, we expect an outlay of those figures, $125 million of those to be spent next year.

Mrs. MEYERS. OK. So in the summary in the budget briefing book, on page 2 the figures at the bottom of the page are the ones you just gave me, $858 in 1992?

Mr. BOWLES. Yes, ma'am.

Mrs. MEYERS. OK. Now, does the $1.056 billion, that does include the $141 million that you—no, that does not include that at all.

Mr. BOWLES. It excludes all supplementals or proposed supplementals.

Mrs. MEYERS. OK. The deep drop, the 17 percent less that you are requesting, means that the 7(a) loans you anticipate generating, $6.6 billion in loans, costs $154 million, or about $155 million dollars.

Mr. BOWLES. $154.8 million.

Mrs. MEYERS. OK. As opposed to generating $3.3 billion worth of loans or $4.9, I cannot remember, $3.3 billion, I think, of loans with $318 million in 1993; is that right?

Mr. BOWLES. That includes part of a supplemental. Let me give you some easier figures to work with.

Mrs. MEYERS. OK.

Mr. BOWLES. In 1993, we intend to support a program of $3.6 billion with a subsidy of $197.9 million. That is composed of the original credit subsidy of $177.8 million, plus $20.1 million carried forward from a previous year. So that is $197.9 for $3.6 billion. We have requested $181 million, which will support $3.3 billion. Of course, that is all at a 5.47 percent credit subsidy rate. The total of that is $378.9 million, to support a program of $6.9 billion in 1993.

In 1994, we are requesting $154.8 million to support a program of $6.6 billion. The difference is $224.1 million in budget authority, and the difference in the program is $300 million in program level.

Mrs. MEYERS. Now, the reason that you can do that is because of that loan subsidy rate that on page 5 has dropped to $3.35 million.

Mr. BOWLES. Yes.

Mrs. MEYERS. That is because—the reason it has dropped is because you are asking the banks to take more of the responsibility at the 75 average rather than the 81 average, and because of the interest rates that you are anticipating that we pay.

Explain to me why that loan, that subsidy rate has dropped.

Mr. BOWLES. Let me kind of walk you through that.

To reduce the average exposure from 81 to 75 percent, we reduced the guarantee on loans of less than $155,000, from 90 to 80 percent. We will reduce the guarantee on the loans of greater than $155,000, from 85 to 80 percent. We will reduce our PLP, which are Preferred Lender Program loans, from 80 to 75 percent, and the

guarantee on our real estate loans will be set at 70 percent. The combination of those factors takes the average exposure from 81 to 75 percent. That is just part of a story. But the other part of the story is the half point fee we are going to charge in the secondary market.

Mrs. MEYERS. What I am trying to get at is the fact that our 7(a) Program, although we are asking less in Section 7(a) money, will actually generate more loans because that subsidy rate has dropped. Is that accurate?

Mr. BOWLES. Yes, ma'am.

For $154.8 million, we believe we can generate $6.6 billion worth of loans.

Mrs. MEYERS. That is what I am trying to bring out. Now, can you give us a couple—I think there are a couple of reasons why that subsidy rate has dropped, and if you will tell me what those are.

Mr. BOWLES. The basic reason for subsidy drops is the risk drops. That is the principal reason involved.

Mrs. MEYERS. The risk drops because we are going from 81 average——

Mr. BOWLES. Yes, ma'am.

Mrs. MEYERS. To 75 percent.

Mr. BOWLES. Our exposure is less.

Mrs. MEYERS. Our exposure is less, and the interest is less.

Mr. ROSENBAUM. In addition, the fees that we get from the secondary market create an income which has the effect of reducing the subsidy rate.

Mrs. MEYERS. Reducing the subsidy rate. OK.

Mr. ROSENBAUM. Yes, ma'am.

Mrs. MEYERS. Because we are taking that half a percent?

Mr. ROSENBAUM. Yes, ma'am. We have a .5 percent fee on all trades that occur in the secondary market. This generates about $67 million a year, and this reduces the subsidy rate by 1.02 percent.

Chairman LAFALCE. Yes.

Mrs. MEYERS. OK. I understand.

Chairman LAFALCE. I have allowed Mrs. Meyers about 10 minutes now, but because of the importance of her question I wanted you to dwell on it. I think this is important. Mrs. Meyers, I am sure, wants to reduce the subsidy and reduce spending to the maximum extent possible, but without impairing the effectiveness of any program offer.

I am sure that any banker will want to maximize the governmental guarantee, and rebel against any reduction in the governmental guarantee, and also do without any fee, and a half percent is, in a sense, a fee for participation in the secondary market.

Could you explain to us your judgment as to why you think the arguments that we could expect to hear from the banking community would be in error? Why would this still be a very good deal for them to participate in, and why do you think that we would be able to continue these 7(a) guarantee programs unabated?

Mr. BOWLES. Sure. First of all, I think it is important to understand the reason why we are doing it. The only reason we are primarily focusing on reducing the subsidy rate is to generate these

savings, to do our part in the shared sacrifice that we all must do if we are going to be serious about attacking this deficit. So the deficit is the reason that we are taking these steps. It generates substantial savings for the taxpayers.

I do not expect it to be a very popular measure with the banking community. Any time you ask them to increase their exposure with no commiserate return they are not going to be particularly happy about it. So I do not expect for the bankers to come in here waving their arms saying this is the greatest thing since sliced bread.

On the other hand, I do believe that this program remains a very profitable and attractive vehicle for the banking community. I expect, while they will complain and complain vigorously, that they will still participate in the program.

I think the loan valid concern that people—that you could expect to hear people express about the reduction in the subsidy rate deals with the concern will this drive the marginal credit or the marginal borrower away from the program, and that is a concern that we share, and one of the things that we are currently looking into.

As I know Ms. Meyers heard when she came to some of the meetings we had with the President, the President has asked me to check with the banking community and check with our SBA loan officials to make sure and to see what kind of effect his initiatives to increase the number of character loans are having in the marketplace, to make sure that the banks are beginning to make these character loans too.

I want to make sure that I have a chance to talk with our people in the districts and talk to a number of lenders to see what they believe will be the effect of a change in this subsidy rate, and see if that will cause—they believe it will cause the banks to become less willing to make some of the marginal loans. If in fact that is the case, then I am willing to revisit some of these revisions.

My feeling is that that will not be the case; that the program will remain profitable and lucrative enough for the banking community that they will continue to want to make these loans, and that the demand will be there for $6.6 billion of loans, and they will continue to support the marginal credit too.

Mrs. MEYERS. Thank you, Mr. Chairman.

Chairman LAFALCE. Mr. Lancaster.

Mr. LANCASTER. Thank you, Mr. Chairman.

Thank you, Mr. Bowles. I would simply reiterate the concerns of Mr. Smith on disaster lending, and in particular would emphasize the need for us to recapture the disaster loan payments for our use in a revolving fund, something that was denied us in the 1990 agreement.

The only thing that I would ask that you comment on, Mr. Bowles, is on the SBDC Program, which you mentioned very briefly in your oral remarks. I know the great value of that program in North Carolina, and realize that earlier this year that there was some consideration given to eliminating that program.

I would ask you, if you would, to tell us a little bit more about your plans for that program that I think is so important?

Mr. BOWLES. Just let me say that clearly the SBDC Program at a funding of $67 million is in the budget. It has the full and unequivocal support of the administration. I think that the administration, having had a chance to have some input from the SBA, now fully understands the important role that the SBDC Program plays in providing advice and counsel to the small business community in any number of areas.

Clearly, I have visited the same one that you have at Chapel Hill, and I am aware of the good work that they do. I have talked to a number of our SBDC people, and I am strongly in support of that program.

Mr. LANCASTER. Thank you.

Chairman LAFALCE. Mr. Zeliff.

Mr. ZELIFF. Thank you, Mr. Chairman.

Getting into the economic program on the Sub S corporations, we would like very much to have you take a second look at that as well. I think that Mr. Smith's comments are right on the mark.

In some Sub S situations where you are involving individual tax rates, it could go from 28 to 40 percent. That does not create much in the way of jobs. It could be a real disaster. Admittedly, the regular corporate rate would go from 34 to 35 percent. That may be achievable. But in New Hampshire, where we have had bankruptcy of public service, bankruptcy of the New Hampshire Electric Co-op, a lot of problems that we have in getting Seabrook on line, whereas now the fifth-highest energy State in the Nation, and putting a BTU tax on top of that, and then increasing these individual rates, it is really going to do an awful lot of—raise havoc with the small business community.

So if you are willing to take a look at that. I understand that the investment tax program does not have much of a future at this point. So there are not that many offsetting pluses.

In terms of the 7(a) loan program and the SBDC Program, I would like to echo the comments that have been made on the Small Business Development Center. The work that is being done at the University of New Hampshire has been outstanding. Helen Goodman does a terrific job. Particularly the situation where businesses are really hurting and struggling. We have had five out of seven of our top banks go down and change hands. Other banks have gone out. Many, many businesses are getting caught in the middle of this thing through no fault of their own.

The 7(a) lending program has been a real life saver. I just worry about making changes at this point in terms that we have just now worked hard to get this program in place, where it is really the only thing that has really been saving in bailing out and keeping people's doors open.

I encourage you to contact some banks and some businesses. If you would like to come up to New Hampshire to do that, we could make very valuable use of whatever 2 or 3 hours that you have in trying to set up some appointments.

I am not saying that it cannot be done. But I would hate to see us take a program and destroy one of the very few programs that we have.

I go back to the goals that you have outlined in your comments here that the President has outlined. They are good goals. But just

taking a look at the credit crunch piece and the step forward that the President has tried to do in terms of character lending.

I think that if you go to New Hampshire that you will find that it has not hit the grassroots. It has not hit the bank level yet, in terms of the loan level to small businesses. Certainly what sounds good on the top, if it does not get it implemented on the bottom, it has not done much to help us.

So I encourage you to take a look there. Again, I would certainly offer an invitation to have you come up to New Hampshire and take a look. Because we are a small State. You can get a really good picture of how bad and how tough things really are.

I guess my one question that I would have is with a 17 percent reduction in funding, are you planning to review existing programs including the Tree Program, and see if we cannot take and maybe put some priorities on where I feel and maybe get your thoughts on what you think the high priorities are and what you think the low priorities are, and are there some moneys that can be generated from that process.

I guess one question would be could you comment on the Subchapter S situation, and the BTU tax in general, and whether you think it is job creative, or whether in fact it would be a drag on the economy relative to jobs, particularly to small business?

Mr. BOWLES. Congressman, you covered a lot of ground there. Let me see if I can try to address some of your points. If I miss one, I would be glad to come back to it.

First, as it relates to the credit crunch, let me assure you that the administration has every intent of trying to get more money into the hands of small business and not less.

I caution you to remember that we are asking in the 7(a) Program for $6.6 billion worth of funding. We are trying to do it in a manner that saves the taxpayers dollars. We believe that this is a very lucrative program to the banks. We believe that we can still generate the $6.6 billion in funding by saving the taxpayers dollars. We think that is important. I am sure you do.

Two, we have asked for $6.6 billion rather than the $6.9 billion that we are asking for this year. Because we do think that there will be some positive effects from the President's initiatives to generate character loans. Again, most of the economic reports that I have seen have shown that most people believe that could free up as much as $38 billion of new capital going to small businesses. So we hope that the $6.6 billion will be satisfactory. It is one of the things that we are reviewing now.

Chairman LAFALCE. Let me just say that we all hope that will be the case. But if it is not, I hope that you will be prepared to come back with a supplemental, if need be, because oftentimes, the SBA window is the only window. In a previous Congress, we did authorize for fiscal year 1994 approximately $8 billion in 7(a) guarantees. I just want to make sure that you are aware of that.

Mr. BOWLES. Yes, sir. I am going to try to make sure that we ask for enough. My style is not to come back and ask for a supplemental. Clearly, if demand far exceeds the supply, then I will come back and let you know. That will be a decision that you all will clearly want to review.

As it relates to the Sub S situation, the information that I have been supplied by the Treasury Department shows that there are about 7 million taxpayers that filed their tax returns with the primary source of income coming from a trade or business. Of that, approximately $300,000 or 4 percent would be affected by the increase in the marginal rates. Clearly, that will have an adverse effect on those $300,000, and I am aware of that.

Mr. ZELIFF. I am one of them. I understand. But it is too bad that with a business that my son runs with 54 employees. If we are typical of the average Sub S, there are a lot of jobs on the line.

Mr. BOWLES. I understand the negative portion of what happens in an increase in the marginal tax rate of those $300,000. I truly do. But I think that you have to look at the President's package in its entirety. Again, you have to look at it in terms of a shared sacrifice that we all must make to reduce this deficit. This deficit is something that we have inherited, and we must do something about it, and we must do something about it now clearly.

I think that if you look at the entire package of the small business community, that you will see some pluses. You mentioned the ITC. It does not look like the ITC is going to make it now. But hopefully, the increase in the expensing provision from $10,000 to $25,000 will help in that regard.

Hopefully, the extension, the permanent extension, of the R&D tax credit will be helpful. Hopefully, the increase in the 7(a) lending program will be helpful. Hopefully, the character loan initiative will help. Hopefully allowing the sole proprietorships to continue to expense 25 percent of their health care costs will help. I think again looking at the President's package in its entirety is the appropriate way to look at it.

The BTU tax, clearly that again is another concept that comes under this shared sacrifice in order to reduce the Federal deficit.

Mr. ZELIFF. If I could just make one quick comment, Mr. Chairman. I do not want to be too derogatory here. But in terms of shared sacrifice. We had a Merrimac town meeting. A 12-year-old came and raised his hand. Phil Graham and I were doing it. He said, "Congressmen, I am 12 years old. I sent an $82 check to the Government on April 15th for my little pen business. If you guys keep taking away all of my profits, there is no point in me working in the pen business. I ought to just get out of it and go play football with my friends."

In my case, we have the FICA tip situation in the restaurant business. We are also in the shared sacrifice getting hit from 85 to 50 percent on meal deductibility, which is a legitimate cost of doing business. We are going to get hit from 28 to 40 percent on individual tax rates. We are going to get a BTU tax.

Frankly, I share Duncan Steffens' 12-year-old comment, why should I bother?

I only throw this out and this line of reasoning in that we need you to be the voice for small business. I want to line up and step up right behind you. I just hope that from a small business point of view that we can take a look at this whole thing. If it does mean putting people back to work and getting our economy turned around and living within our means, that is great. If it does not, then we ought to do it before it is too late.

Mr. BOWLES. Congressman, clearly as I stated in my goals, I have spent my whole life in the small business community. I have financed and grown any number of small businesses. I clearly understand exactly what you are saying. My job is to make sure that that message gets to the President, and that he takes it into account before he makes decisions, and that is what I intend to do.

Mr. ZELIFF. Great. We wish you well.

Mr. BOWLES. Thank you, sir.

Chairman LAFALCE. Mrs. Clayton.

Mrs. CLAYTON. Thank you, Mr. Chairman.

Mr. Bowles, I, too, want to share that hopefully the impact of reducing the extent of the subsidy and increasing the risk does not have an impact that will discourage the participation parts of banks for that.

Mr. BOWLES. Mrs. Clayton, I promise you that we are going to look at that, and look at it very, very closely.

Mrs. CLAYTON. Thank you. I am reminded though that through the 502 and 504 that there is a substantial reduction in the participation in terms of the Government of 45 percent. I am from a rural area. As you know, in rural North Carolina, that particular program is used extensively. It is only a 45 percent. So there is some evidence of it. But still, you would not want to have the excuse by the lending institutions to not increase the area.

One of my concerns—I have three concerns, and I will be very brief—one of my concerns though is about the one half cents in terms of the income. It is not so much that it will discourage the bank by our getting an income, but it is to begin to see why banks sell those loans in the first place.

They sell those loans supposedly to have more capital to lend again. But also, oftentimes small businesses have found that they sell the loan in this first instance with the underwriting requirement of what they propose to be the secondary market. Therefore, as it is now, it does not encourage the risk taking.

Could you comment on the banks now looking at that as a way of possibly being a deterrent in their making loans, because they want to sell to the secondary market, and therefore they invariably take on the underwriting criteria of the secondary market rather than begin to have a little more venture in taking risks with their borrower.

Mr. BOWLES. Mrs. Clayton, let me address both of your points. First, on the 504 Program, that is truly one of our most cost efficient programs. The budget this year for 1993 calls for about $700 million in that program. We think that the demand will be in excess of that. However, we are legislatively limited to $736 million, I believe, for this year in that program.

Chairman LAFALCE. That is something that we will want to look at. We may want to increase that.

Mr. BOWLES. We think that the demand will probably be more in the area of $800 million for this year. In the budget for next year, we have $761 million for the 504 Program. So that is a program that we plan to expand. It is also a program that is a very cost efficient program for us to manage.

Mrs. CLAYTON. Is that the only program that you have for rural communities?

Mr. Bowles. No, ma'am, it is not. We have a number of other programs. One of the programs that I like a lot is the microloan program, which is one that is in a test phase now, which I think can really be an effective tool to use in both the rural and urban communities. With the microloan program, we hope to make loans in the amount of an average of about $7,500 each. I have heard so many people say gosh $7,500, that is not enough to do anything. But they are really wrong. Because if you look at the real statistics, over two-thirds of the businesses started in this country are started with less than $10,000, and half of them are started with less than $5,000.

So we think that this will meet a real need in the marketplace, and we look forward to evaluating it as we go forward, to see how effective it really is.

What was your other question?

Mrs. Clayton. The underwriting criteria with the secondary market being the driving force for banks making their loans.

Mr. Bowles. I am a strong believer that we need to have a more active secondary market. I think the secondary market is important to the small business community. Currently, about 50 percent of the loans that are made with the 7(a) guarantee are sold in the secondary market. In 1992, about $2.1 billion worth of loans were sold, and about $1.2 billion worth of loans were resold.

There are any number of proposals that are before the House and Senate now to improve the secondary market. Congressman LaFalce has one that I reviewed to a great extent. There is a proposal, or I think there is legislation that requires the SEC, and the Treasury Department, and the CBO, and the SBA to look at the secondary market and see ways that we can facilitate and make it better. That report is due, I believe, on September 4th of this year. We are actively participating in that review of it now.

I believe that if we are going to have a more active secondary market, that we have to standardize our loans more, and that could lead to some of the negative parts, and that could lead to some of the problems that you are talking about now. It is simply one of those things that I will have to look at. There are some positives to it, but clearly you mentioned one of the negatives.

Mrs. Clayton. I just want to finally ask about the minority participation. I noted that I guess the MESBIC Program has increased.

Could you just comment on your plan, not in terms of moneys, but just in aggressiveness in marketing SBA with minorities, and that includes women and other disadvantaged communities.

Mr. Bowles. Yes, ma'am.

Mrs. Clayton. Part of it is not the availability of the money. Part of it is what is perceived as procedure or bureaucratic. It is relationship, it is understanding, it is information. It is also staffing. I do not know if you staff that up. But obviously, it is resource, and who you have there is going to make a lot of difference as to the way people perceive that as an acceptable agency.

Mr. Bowles. First, as it relates to staffing. We are reviewing the entire staffing of the organization. My management philosophy goes to pushing the people and the assets down to the field. That is where I believe the dollars should be spent. That is where we are making our loans. That is where we are doing our Government pro-

curement. That is where we are giving advice to the consumer. That is why I believe the assets should be in the field, not in the regions, and not in headquarters here in Washington. So that is my overall philosophy as it relates to staffing.

As it relates to women owned businesses, I think that the job that we have done is very poor. Today 32 percent of all sole proprietorships are owned by women. We expect that that number will reach 50 percent by the end of this decade. Women owned businesses now employ more people than the Fortune 500 in total. Yet when you look at the Government procurements that go to women owned businesses, they are less than 1.5 percent. It is a pitiful job.

Mrs. CLAYTON. What about other minorities?

Mr. BOWLES. What I was going to say is I do not know how we are going to do it better. But I promise you that we have already formed a task force to look at it.

As it relates to the minority populace, one of the programs that people talk about the most is the 8(a) Program. I think that the 8(a) Program has made great advances over the last several years. But believe me, it has a long way to go to become an efficient and effective operation.

Two, if you look at the number of minority firms that have participated in the 8(a) Program, in its history there have only been about 9,500 firms that have participated in it. Last year, there were only 4,500 firms that participated in a $4.3 billion program.

It is hard for me to imagine why the number is so few. I have spent some time talking with a woman in New York Harriet Michele who heads a program that tries to connect minority suppliers to larger private corporations.

She has over 16,000 minority suppliers participating in her program. We only have 4,500 in ours. Clearly, we have got some work to do to find out how we can do it better, and how we have better outreach.

I talked to one of the winners this year of the 8(a) award program. She had been 2 years in application. We are supposed to be 90 days in application. The information that I received is that the average is about 120 days. I know that we can do it better. Again, I have only been on the job for 10 days. But I promise you that it is a priority of mine to reach out to the minority community. Not just with the 8(a) Program, but with the 7(j) Program, with our normal advisory programs.

We must empower all Americans, if we are going to have a chance at real economic opportunity in this country. I am going to focus on it, just as I have in North Carolina, as you are aware.

Mrs. CLAYTON. Mr. Bowles, I appreciate those answers. I look forward to your leadership.

Mr. BOWLES. Yes, ma'am.

Mrs. CLAYTON. Thank you, Mr. Chairman.

Chairman LAFALCE. Thank you.

Mr. Bowles, Mrs. Clayton mentioned a number of things that I would like to pursue just a bit. First of all, you discussed the importance and the great leverage of the 504 Program. I authored that program and take a special interest in it. I think that it, and its predecessor 503, have been perhaps the most successful SBA Programs dollar for dollar.

Mr. BOWLES. Congressman, that is exactly right.

Chairman LAFALCE. I think that Senator Bumpers can take primary responsibility for the microloan program. But I do know that we have an operation in Western New York, and it has worked extremely well there under the leadership of what is called Rural Opportunities, Inc.

But there is another program that I want to mention now. That comes under the 7(a), but it is the SBLC Program, the Small Business Lending Company Program. I think that there are about a dozen throughout the country that have been licensed by the SBA.

Are you familiar with that?

Mr. BOWLES. I know what they are, yes.

Chairman LAFALCE. OK, good. I think that the last one that was done was one which I assisted to get off the ground. We had to convert one license from a defunct SBLC to this one. It was the Grow America Fund.

The reason that I mention this is because we have a number of things now. This microloan program. The CDC or the 503 and 504 Programs. The SBLC Program, especially something like the Grow America Fund, which targets certain communities. The investment capital is contributed by communities, for example, the city of Rochester tossed a million through their community develop block grant money. The city of Niagara Falls tossed in a certain amount of money. Using this money as leverage, they then are able to go out in the community.

My point is in connection with the community development bank proposals of the Clinton administration that have not come down yet. We had a briefing yesterday at the Banking Committee from Bob Rubin and Frank Newman. As I listened to them and saw the young people who were their assistants, I suspect that they were in high school when I first started in Congress, and I thought they are trying to reinvent the wheel.

One of the things that I did in the late 1970's was to bring in the SBA, and HUD, and EDA, and Commerce into my office. I said you have a million programs, they are excellent programs, but you are not working together. You are not being effective. You are not targeting the resources. You are not coming up with a combination delivery mechanism.

Can you not enter into a written agreement, an interagency agreement and target a number of cities, let us say 25 cities. They did, and they worked together. They came up with a written agreement, and they signed it. They targeted 25 cities. They hired a group to come in and teach public officials within the cities through their economic development department how to do economic development, utilizing the resources of the Federal Government.

Under this community development bank concept or corporation concept, one of the directors of this corporation is going to be the administrator of the SBA.

Mr. BOWLES. Right.

Chairman LAFALCE. So, you are going to be at the table there. I encourage you to become fully aware of what is going on, and then try to get them to utilize the existing resources. We have some great resources here. We do not have to reinvent the wheel. We

could use the SBLC Program or some of them in a very focused and targeted way, greater utilization of 504, greater utilization of the microloan program.

There is your community outreach. SBA can be not just one of many, but the SBA can be the leader in this. Who do they want to help in these community development proposals? It is the small business community, at least insofar as your commercial component and industrial component.

The community development banks are not supposed to help Fortune 500's. It is exclusively small businesses. Now there is a residential component of it, too, I understand. That would have to involve other agencies. I encourage you to really hop into this one. Maybe you have already, I do not know.

Mr. BOWLES. Mr. Chairman, that is exactly the reason that the President wanted the administrator on this board. I understand exactly what you are saying.

Chairman LAFALCE. We will talk about that some more.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

I notice the list of percentages that you are going to go down to on your maximum guarantees.

Mr. BOWLES. Yes, sir.

Mr. COLLINS. I interpret that to mean that the majority of your loans are actually real estate loans?

Mr. BOWLES. I think that 56 percent of the loans that we make are real estate related. As you know, we only make real estate loans as they related to a trade or business. We do not make real estate loans as income producing property.

Mr. COLLINS. That is a much better piece of collateral anyway most of the time.

What is the average interest rate paid by a borrower?

Mr. BOWLES. Well, it depends on the length of the issue. Correct if I am wrong, Larry. For loans that are less than 7 years, it is prime plus 2¼. For loans greater than 7 years, it is prime plus 2¾.

Mr. COLLINS. Is that the maximum charge or is that the average charge?

Mr. BOWLES. That is the maximum charge.

Mr. COLLINS. What is the average charge?

Mr. ROSENBAUM. Congressman, the average charge usually runs about a half to a third points below the maximum. It is usually somewhere around 1¾.

Mr. BOWLES. Half of the loans that we are making are made at the maximum rate.

Mr. COLLINS. In other words, the banks could in essence go to the full allowance, and not have to increase interest rates based on the half of the percent that the Government will be receiving from the loan proceeds?

Mr. BOWLES. Are you now talking about for our sales in the secondary market?

Mr. COLLINS. Yes. The half of a percent, banks could actually go ahead and charge the borrower then the full max, seeing that they are half to two-thirds below that now, and not really have to ask for an increase in the ceiling in the amount of interest that they could charge.

Mr. BOWLES. Half of the loans now.

Mr. COLLINS. There is room enough in there.

Mr. BOWLES. There is some room.

Mr. COLLINS. You are saying that the half a percent is a saving to the taxpayer. But it is actually not expended to day, so that will actually be an earning.

Mr. BOWLES. It will be income, right.

Mr. COLLINS. Based on the administration's proposal for tax increases and how they affect business, and in your advisory section, how are you dealing with pro formas as you advise businesses based on those tax increase proposals?

Mr. BOWLES. I am sorry, Congressman, I do not understand your question.

Mr. COLLINS. You have an advisory section where you actually will sit down with a small business person.

Mr. BOWLES. Sure.

Mr. COLLINS. You will walk through a business and establish a pro forma.

Mr. BOWLES. Yes, sir. I can answer your question now. Any time our people sit down to advise any business, we have to do cash-flow statements going forward to look at how much cash they will have available to service their debt, to make capital expenditures, and have enough working capital to finance their future growth. That is what you need cash for unless you pay dividends. Those really are the only three sources of cash. Clearly, we will have to take that into account, any additional taxes that they have to pay will reduce the cash-flow that they will have available.

Mr. COLLINS. Very good.

On the minority loans, why is the minority loan loss ratio reserved 28.83 percent projected versus 2.35 percent for other type loans?

Mr. BOWLES. I cannot answer that.

Mr. ROSENBAUM. Congressman, the 28 percent is the subsidy rate I believe that you are referring to in the minority program. It reflects the risk that we have sustained and the losses that we have sustained in the program.

Mr. BOWLES. I am sorry, I did not understand your question.

Mr. ROSENBAUM. In other programs, we have different subsidy rates. Like the 7(a), the general business guarantee loan program, which this year has a 5.47 rate. Once again, these subsidy rates reflect the risk and the cash-flows that come in and out of the program.

It is a risk rated assessment. It is just like the SBIC Program has a 15.4 percent risk rated assessment, and the 7(a) Program has a 5.4 percent subsidy rate.

Mr. COLLINS. I understand that, but my question is why is it so much higher in that one section?

Mr. BOWLES. I am sure it is because our loan loss experience is probably higher.

Mr. COLLINS. Why is the loan loss higher? We will get right to the point of the question.

Mr. ROSENBAUM. To be honest with you, Congressman, it is the nature of the way that the program was designed. We have had to administer it in that manner.

Mr. COLLINS. I will follow up with a statement on that. I think that the failure rate for the minority businesses can have an impact on other minorities even to apply to you for loans. If they see others applying and receiving a loan and failing, why should I get in that trap with you?

Mr. ROSENBAUM. Congressman, one other comment. We are kind of mixing apples and oranges. I believe that the program that you are referring to is the MESBIC Program, which is a venture capital program, and not strictly a loan program. When you are dealing with venture capital, your risk is significantly higher than when you are dealing in debt capital. So we are mixing apples and oranges. Those higher rates in the MESBIC Program reflects a venture capital program as opposed to a debt program.

Mr. COLLINS. But both of those fruits belong to the taxpayer?

Mr. ROSENBAUM. That is correct.

Mr. COLLINS. Thank you.

Thank you, Mr. Chairman.

Chairman LAFALCE. Mr. Tucker.

Mr. TUCKER. Yes, Mr. Bowles. I also represent some taxpayers in my community. They are very concerned about the lack of participation for minority loans. In fact, the question was asked of you by Mrs. Clayton about loans to women. I believe that you were very expeditious about giving that figure. But you did not give the figures as they relate to the very dismal record of minority participation in loans.

The recent statistics that I have seen in terms of minority participation, and specifically in terms of African-Americans, is very, very low. I think that notwithstanding some of the overtures and maybe encouraging implications of the President's initiative toward character loans and some of the other statistical data and experimentation that you are doing, I think that my taxpayers would have me say to you that it is time for the SBA to get off the dime and to do something about providing startup loans for people who are out in places like Los Angeles and south central who need an opportunity to start some businesses up.

How much studying do we have to do to figure out that these people need some startup loans between a dollar and $50,000? I mean, when we look at what small businesses need, and you mentioned the average loan or the microloan program was something about $7,500—is that correct, is that the figure you gave?

Mr. BOWLES. Yes.

Mr. TUCKER. Those kinds of loans can go a long way in franchising a lot of these minorities into business opportunities. I believe that we should not just sit back and wait to see what the impact or what the effect of the presidential initiative or the administration's initiative is for character loans, but that the SBA should take some responsibility and really move into high gear on the microloan program and some of the other programs that the Chairman talked about.

I do not see why in any way, shape, or form that the very low record as to minority loans has been consistently low.

Can you respond to that?

Mr. BOWLES. I think I can.

Mr. TUCKER. One other quick thing before you respond. I just want to say this. As to your outreach in the MESBIC's, please use the CBC, and use the minority subcommittee of this committee for any information and resources that you need. Because I do not think that there is any excuse for saying that you cannot find viable resources out there. The resources are out there. Suppliers are out there. If you do not know where they are, we will help you find them.

Mr. BOWLES. Congressman, I was not making any excuses. I said that it was something that I wanted to do. I am agreeing with you.

Mr. TUCKER. I am just making a suggestion to you, letting you know that we will help you. We will take you by the hand and show you.

Mr. BOWLES. Thank you. I went by to meet with Congressman Mfume just to do that very thing.

Mr. TUCKER. Good.

Mr. BOWLES. I am determined to work for economic empowerment for all Americans. It is a priority of mine, and it is the priority of the President. The 7(a) Program I think provides currently about 15 percent of its capital to minority owned firms. I think that the minority business populace is somewhat less than 15 percent now. The surety bond program provides about 15 to 18 percent of its capital to minority owned firms.

We can do a better job. We will do a better job. We have to focus our efforts. We have to see other ways to do it. As it relates to the 8(a) Program, we have to actually go out and meet with people like Harriet Michele and find out how she is doing a better job than we are, and how we can do better. I cannot tell you more than that at this point in time. But I am determined to look at it to see how we can be more efficient and effective, and do a more efficient and effective job, and at the same time reach out to the minority populace.

Mr. TUCKER. I appreciate your voice of interest. I think that that has not been the rule, and has not been the situation in the past few years. If in fact you are serious and you are committed to doing that, then I am sure that we will do a better job. Because the job that has been done—as I say, it is not a reflection on you, you are just getting on the job—has not been satisfactory.

I was sincere in saying that myself and anyone else, Congressman Mfume and anyone else, would sincerely work with you to toward that effort.

Mr. BOWLES. Congressman, I said in my opening remarks that I wanted to be held accountable. I do want to be held accountable. I want to be judged on what we do over the next 4 years. I have committed to the President to stay the course. I hope when we look back over this 4 year period that you will see that we have done a lot of things that make you very proud.

Mr. TUCKER. Thank you.

[Mr. Tucker's statement may be found in the appendix.]

Chairman LAFALCE. Thank you.

Mr. McInnis, do you have any questions?

Mr. MCINNIS. Thank you, Mr. Chairman.

Mr. Bowles, bear with me a minute, because I want to walk through this.

The million dollars that you have in your budget will leverage what amount of small business loans?

Mr. BOWLES. It depends on the program. Each one has a different credit subsidy rate. Let me give you an example. For the 7(a) Program, currently it has a 5.47 percent subsidy rate. So a million dollars will fund approximately $20 million. At the same time, if you take the program that we talked about with the Chairman, the 504 Program, it has only a .5 percent subsidy rate. So you can see the huge difference where you get your real bang for your buck.

Mr. MCINNIS. First of all, let me tell you that your statements about saving the taxpayers dollars, very commendable, which I think you have said. Now with that consideration on the 7(a) Program, let me ask you.

Mr. BOWLES. Yes, sir.

Mr. MCINNIS. To put as much money as possible into the small business community. I am moved by the remarks by our college at the end of the table who talked about the minority community. "shared sacrifice." I think that those are honorable statements. But when I first opened up your budget package, I saw $17 million to plant trees. So by my calculations, which you just walked me through, we could leverage an additional $140 million in small business loans, but you in fact have chosen to spend the $17 million planting trees.

So I would like to know from you exactly how it is that you justify a $17 million expenditure condemning your comments about shared sacrifice and with the leverage factor that we know exists, how is it that you justify the $17 million for tree planting in your budget?

Mr. BOWLES. Very easily. We are legislatively mandated to spend those funds to plant trees. Therefore, my job is to make sure that we spend it efficiently and effectively.

Mr. MCINNIS. Is it not also a part of your job, Mr. Bowles, or do you feel it is an obligation as well, to go to the President or to go to the Congress and say "look, this $17 million would leverage an additional $140 million, maybe for the minority community, maybe for the small businessman." Regardless of that; do you plan to take that step at all?

Chairman LAFALCE. If I could just interrupt for a second. I understand fully the perspective of the gentleman. Of course, there are always cross-currents at work, too. I do know that two individuals on the committee have spoken to me thus far about this $17 million. One was Congressman Neal Smith, who thinks that it is extremely important. One, the ranking minority member, Mrs. Meyers, who said that she considers it very important, too. She hopes that we could contain it.

I just want you to know going in that while there is merit to what you say, and there is merit to the proposal, there are competing things that you can do with money. I do know of two individuals who feel very strongly about the tree program.

Mr. MCINNIS. I appreciate the comment from the Chairman. But I do not know of a small business in my district in Colorado to whom I could justify planting $17 million in trees when I tell them that we could leverage $200 million worth of loans.

Chairman LaFalce. One more thing, too. I remember when President Bush came before the Congress. He set out as one of his primary goals the planting of 1 billion trees during his term of office as important for the salvation of this planet. Also, it will help in community development and it can create jobs, too.

But there is absolute validity to what the gentleman from Colorado has said. If you used that money elsewhere, you could use it for different programs. You could use it for minority loans. You could use it for loan guarantees, et cetera. So it becomes a question of what do you want to do in the aggregate.

Mr. McInnis. Mr. Chairman——

Chairman LaFalce. You will be given additional time.

Mr. McInnis. Thank you. For your information, Mr. Chairman, I certainly did not concur in the previous President's planting of trees as well. Anyway, back to Mr. Bowles.

Mr. Bowles, what is your position in regard to the $17 million in trees? I do not want to hear it being efficiently spent and so on. Do you support that $17 million in trees, or do you think that the money would be utilized better elsewhere—for example, in leveraging the program of which you just spoke?

Mr. Bowles. Congressman, I hope that you do want to hear about efficiency and effectiveness. Because that is a big part of my job.

Mr. McInnis. My question, Mr. Bowles, is, do you support the $17 million expenditure for tree planting, or would those moneys be better utilized in another program?

Mr. Bowles. First of all, I think that we should characterize the tree planting program correctly. It is a matching program. The funds are matched by the States. It is a high job generator for low-paying jobs. In addition, the tree planting goes to small business, the nursery industry. So therefore, it does have some positive impact on small business. In addition, the GAO gave a very positive report on the 1983 three programs that the SBA administers.

Would I choose, if I had my choice of where to spend my money, to spend it on trees? No, sir.

Mr. McInnis. Mr. Chairman, advise me when my time is getting close. Mr. Bowles, let me ask you, in regard to the proposed health reform plan, and if there is a proposed payroll tax for health care on the businesses in the Nation, have you done any thought about the impact that it might have on small business?

Mr. Bowles. Oh, sure.

Chairman LaFalce. And your thoughts?

Mr. Bowles. As it relates to the health care crisis our country is in, I do not think there is any question that small business has been disproportionately adversely affected by the real mess our health care system is in. The cost of health care has increased by 20 to 50 percent a year for small businesses. Small businesses pay on average 30 percent more for the same health insurance that large businesses do. The rate of increase of health insurance for small businesses has grown at a 50 percent higher rate per year.

I do not know if you spend any time working in a small business, but I can tell you most small businesses that I have worked with have tried almost everything they can to hold down the cost of health care. They have tried—they have tried switching programs.

They have tried managed care. They have tried cost containment. They have tried cost sharing. They have tried reducing benefits. They have tried getting their employees to pay a larger percentage of the cost. Nothing has helped. The cost of health insurance continues to sky rocket. The smaller your business is the more disproportionate adversely affected is that small business.

The statistics you see show that it is almost, in spite of that, still about 79 percent of all small businesses do provide some form of health insurance to their employees. I think anything we can do to control the cost, the skyrocketing cost of health care will benefit those small businesses that are currently providing insurance to their employees, and I do plan to have and do plan to continue to have some input into the health care task force.

Mr. McInnis. Thank you. Mr. Chairman.

Chairman LaFalce. Thank you.

Mr. Fields.

Mr. Fields. Thank you, Mr. Chairman.

Mr. Bowles, I have just a few questions I would like to ask you.

Mr. Bowles. Yes, sir.

Mr. Fields. First of all, welcome to the committee, and I know you are about to embark upon a number of tasks.

I want to start with the 8(a) Program. How many businesses, and I would appreciate it if you could give me a ballpark figure. If you cannot, I can understand. About how many businesses in existence today would qualify under the 8(a) Program, an estimate?

Mr. Bowles. Congressman, I do not know how many qualify. I can only tell you how many are participating now. Maybe, Larry, do you know? But there are only 4,300 firms that are currently participating in the entire 8(a) Program, and only 9,500 in the existence of the program.

Mr. Fields. Forty-three hundred firms, you said?

Mr. Bowles. Yes, sir.

Mr. Fields. How many firms would you estimate in the country, how many minority firms do we have in the country? Anybody have that approximate?

Mr. Rosenbaum. We can provide that for the record.

Mr. Fields. That is OK.

Mr. Rosenbaum. We would be more than happy to provide that for the record, because we do have it.

Mr. Fields. Because the reason why I asked that question is because it is such a small number, and I was reading your statement. You said one of the priorities of the administration, as a matter of fact the second priority, was to get rid of unnecessary paperwork and bureaucratic regulations.

What are you going to do as relates to the 8(a) Program in reducing some of the paperwork and red tape that many of the small businesses have to go through in order to qualify and be certified?

Mr. Bowles. Congressman, I have been on the job for less than 10 days. I have done as much homework as I possibly can do prior to being confirmed, and now since taking office. I spent most of the first week involved with Small Business Week.

What I do know is that we can do a lot better. There are a couple of things that I have looked at to make it more efficient and effective. One is removing some of the people who are involved in the

prime contracting phase of our 8(a) Program, and moving those people into the field. I think that will enable us to be more efficient and effective. I have looked at consolidating some of the processing in one office, I think will improve the efficiency and effectiveness. But those are two things I have looked at. I cannot tell you whether those are things we will adopt at this point in time, because I have to do my homework. But clearly we can do a better job.

Mr. FIELDS. OK. Let me give you just a little bit more homework if you can get to the office, get to my office and to the Chairman. I am sure he would share whatever members. I have a particular interest in it and I would appreciate it if you could get the information to me.

One, of the 4,300 businesses that you alluded to in the 8(a) Program, I would to know by breakdown, either breakdown of how many of those businesses are women-owned businesses, how many of them are black-owned businesses and the entire line of minorities.

Mr. BOWLES. I will be happy to provide that to you.

Mr. FIELDS. I would also like to talk a little bit about funding.

Last year's appropriation was right at about—how much was last year's appropriation for the SBA Program—I mean, for the 8(a) Program?

Mr. BOWLES. I think it was approximately the same. I think it has been about $4.2 to $4.3 billion, because it is not an appropriation, by the way.

Mr. FIELDS. Right. But the $4.8 billion that you are speaking of, of that $4.8 how much did you spend last year?

Mr. BOWLES. What we are doing is procuring contracts for firms, and so all of that money—those are contracts that each one of these——

Mr. FIELDS. I understand what it is. I am asking you how much did you expend.

Mr. ROSENBAUM. Mr. Congressman?

Mr. FIELDS. Yes.

Mr. ROSENBAUM. The $4.3 billion that went to 8(a) as 8(a) contractors is not our money. What we do is we work with the procuring agencies, and make sure that the minority community gets their share of Government procurement. These contracts were awarded, and they are expended. They may not be totally expended this year or last year, but they will be expended over——

Mr. FIELDS. Well, maybe I asked the wrong question. Maybe I asked the wrong question. Let me ask the first question.

How much money did we appropriate to the 8(a) Program?

Mr. ROSENBAUM. The actual program dollars for the 8(a) Program, other than some technical assistance money and money for salaries and expenses——

Mr. FIELDS. Excluding employment. I mean, how much—is there any set aside per se for the 8(a) Program?

I understand how the procurement process works. I am sure there are some dollars appropriated, or a figure or a percentage appropriated to the 8(a) Program, is there not?

Mr. ROSENBAUM. We have grant money which gives them technical assistance. That's a 7(j) grant program, and that is technical assistance. It goes some to 8(a) and to other minority programs.

Mr. FIELDS. OK.

Mr. BOWLES. Congressman, the Federal Government lets out contracts each year for about $160 billion for goods and services. Of that——

Mr. FIELDS. Is there a percentage of that that is allocated to—that is what I am asking.

Mr. BOWLES. That is what I am trying to get to.

Mr. FIELDS. OK, I appreciate that.

Mr. BOWLES. Of that amount, approximately a third—I think it was $180 billion, actually. Of that about a third goes to small business, of about $60 billion. Of that percentage $4.3 billion is the amount that was procured under the 8(a) Program. So that kind of gets you to the numbers I think you——

Mr. FIELDS. So what is the actual number? I understand $4.3 billion was actually allocated. Not allocated, but——

Mr. BOWLES. Awarded.

Mr. FIELDS. Awarded.

Mr. BOWLES. Yes, sir.

Mr. FIELDS. The total amount is $60?

Mr. BOWLES. One hundred and sixty is the total. Of that about $60 went to small business in total, and of that $4.3 went to the 8(a) Program.

Mr. FIELDS. So a third is appropriated?

Mr. BOWLES. No, sir. Those are contracts that are let to small businesses.

Mr. FIELDS. I understand that. Let me ask it using maybe some better layman terms.

You have $160-some billion dollars, is that not correct?

Mr. BOWLES. That is what the entire Federal Government has.

Mr. FIELDS. Exactly.

Mr. BOWLES. Yes, sir.

Mr. FIELDS. What percentage of the $160 billion—is it a third of the $160 billion that——

Mr. BOWLES. That goes to small business in total.

Mr. FIELDS. Must go to 8(a) Programs?

Mr. BOWLES. No, sir.

Chairman LAFALCE. There is no set-aside——

Mr. FIELDS. OK.

Chairman LAFALCE. [Continuing.] for the 8(a) Program. There is a Small Business Committee set-aside, and then there are goals for minorities.

Mr. FIELDS. OK. Well, that is my point. What is——

Chairman LAFALCE. Then there is the 8(a) Program, which is neither a set-aside nor a goaled program. It is a Business Development Program.

Mr. FIELDS. OK. Well, what is the goal as relates to the 8(a) Program?

Mr. BOWLES. I will have to provide that to you for the record, Congressman. I am not sure I can answer that accurately.

Mr. FIELDS. OK. Because it appears that we are just doing a shotgun. If we land in a certain area, fine. If we do not, I mean, I would certainly like to know the goal of the moneys that should be——

Chairman LAFALCE. Well, you see, it is not a target. It is not a set-aside program, and I do not believe there are any numerical

goals for 8(a). It is a Business Development Program. So the question is to what extent can we take minority companies and through the use of Government contracts develop them to such a point that they can become independent of the 8(a) Program.

Mr. FIELDS. I am quite aware, Mr. Chairman, of how the program works. I am trying to figure out whether or not there is—you said there was a goal, and I am trying to figure out what is that goal.

Mr. BOWLES. Congressman Fields, that is a very fair question, and I will try to get that information to you for the record. I am sorry. I just do not have it today.

Mr. FIELDS. That is fine.

My final question is the—is it the microloan program?

Mr. BOWLES. Yes, sir.

Mr. FIELDS. How many States participate in that program?

Mr. BOWLES. I honestly do not know how many States. In some States we have two or three. In most States we have one. I think we are getting ready to make the awards at the end of this week or the beginning of next week, and I cannot give you an exact number. I will give that to you for the record. Our goal is——

Chairman LAFALCE. My counsel tells me he thinks there are about 35 States right now.

Mr. BOWLES. I think that is right.

Mr. FIELDS. Do you take economic depression into consideration when you make these decisions?

Mr. BOWLES. I cannot tell you exactly what the criteria are.

Mr. FIELDS. The reason why I ask that question because in The Delta there is no program, microprogram in The Delta, as I appreciate it. There is certainly not one in Louisiana, and I think Louisiana has applied a couple of times through the Chamber of Commerce. When we allocate these moneys that deal with economic development, I really think we ought to have some type of, I guess, conscious to those areas in the country that are economically deprived.

Mr. BOWLES. Yes, sir.

Mr. FIELDS. If you can take that into consideration, I would really appreciate it.

Mr. BOWLES. Thank you. I will report back to you where they are and whether or not we have done that.

Mr. FIELDS. Thank you. I have no further questions.

Chairman LAFALCE. Thank you very much.

Larry, did you want to add anything?

Mr. ROSENBAUM. I was just going to say it is in 44 States.

Chairman LAFALCE. Forty-four States.

Mr. ROSENBAUM. That we awarded, yes.

Mr. FIELDS. Is there one in Louisiana?

Chairman LAFALCE. Is Louisiana one of those States?

Mr. ROSENBAUM. Let me see if I have got the list over here.

No, I do not have the list of States, but we can provide that for you.

Mr. FIELDS. I talked to my Chamber before I left, and there is not one in Louisiana. Louisiana is the second-poorest area, as a matter of fact, in the entire country in terms of rural areas.

[Mr. Fields' statement may be found in the appendix.]

Chairman LAFALCE. Well, perhaps you could not only inquire of whether Louisiana has one, but if they do not have one, perhaps you might try to work with an outreach program, some economic development unit maybe in the Governor's office, to try to bring that program to Louisiana if it does not have one. If it does, maybe you can see if they can extend its jurisdiction beyond where it presently is within the State to permit it to aid the Delta region.

Mr. BOWLES. Mr. Chairman, we will absolutely look into it and report back to you.

Chairman LAFALCE. Advise me of that, too.

Mr. BOWLES. Yes, sir.

Chairman LAFALCE. I have many, many questions. I think we should defer those to some future time when you and I can get together, and we will talk about that after this meeting.

Mr. BOWLES. Thank you.

Chairman LAFALCE. I want to say something, Mr. Bowles. I do not say this just to say it. I say it because it is true. You have shown a greater command of the SBA budget and the SBA Program than any administrator has ever shown, not only after an 8-day period, but maybe ever, even at the end of their 2 or 3 years. I have been here since January 1975, so I have seen the administrators of SBA come and go. It is refreshing not only to see your knowledge of the programs, but to see your sophisticated knowledge and understanding of financial and business issues too. I do not think we have ever had such a sophisticated understanding of an administrator. I think this proves what I said in my opening statement: That you have the capacity clearly to be the finest administrator SBA has ever had. We will work with you closely to help bring that about.

Thank you very much.

Mr. BOWLES. Thank you, sir.

[Whereupon, at 12:25 p.m., the committee was adjourned.]

SBA BUDGET REQUEST

THURSDAY, MAY 27, 1993

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 9:41 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Chairman LaFalce. The Small Business Committee will come to order. We were in very late last night, and then I had my first meeting this morning at the White House at 7 o'clock. That is why I am a little bit late here today. Anyway, we are glad to have you here as the committee resumes its hearings on the adequacy of the budget for the Small Business Administration, primarily with reference to fiscal year 1994, but also as to the remainder of the current fiscal year.

Last week the committee was pleased to receive the testimony from the newly confirmed administrator of the Small Business Administration, the Honorable Erskine Bowles of North Carolina. The principal focus of last week's hearing was the status of SBA's financial assistance programs and the agency's ability to help small firms overcome the credit crunch. The committee is also very concerned with the other major SBA Programs. Thus we are pleased to have representatives from the SBDC Program and the venture capital programs, both of which are very important to the agency. However, particularly in light of the continued shutdown of the 7(a) loan program due to its having exhausted all funding for the year, the emphasis on the agency's financial programs will continue today.

I do want to note for the record, however, that yesterday the House approved H.R. 2118, which will provide an additional $181 million to support an additional $3.3 billion in loan guarantees and carry the program through this fiscal year. The Senate still needs to act. Until this issue is finally resolved, small businesses will continue to be denied critical resources.

I shall continue to press for the earliest possible action. I know how important this is. As part of next year's budget request, this administration, as administrations in the past have done, is proposing additional fees on the guaranteed loan programs and a reduction in the percentage of the loan guaranteed by the Government. But, unlike previous years, this is not being done in a vacuum. It is part of a much broader effort focused on serious, credible, deficit reduction. Unlike previous administrations, this administration is

proposing what the Federal Reserve Board has deemed to be a serious and credible deficit reduction package.

As part of that effort, the SBA has been asked to come up with $169 million in savings. No one would be suggesting a fee or the other program changes that are now on the table if our Government did not need the resources to reduce the deficit. The impact of these changes is substantial from the perspective of cost savings. The Congress will have appropriated over $375 million to support a $6.9 billion loan guarantee program in 1993.

The program changes being suggested could theoretically allow us to appropriate only a fraction of that amount, $155 million, to support a program of almost comparable size. Now, this committee understands that no bank, no lender in the United States, will want to pay a fee if it doesn't have to. Nor would any bank, any lender, prefer a 75 percent guarantee to a larger guarantee. It doesn't take much to understand that there is going to be automatic opposition to that. But it is not unreasonable to charge a fee for a service and some would argue that there are substantive, substantial incentives to participate in the SBA Loan Guarantee Program even with the recommended changes. It is for this committee to determine how we can strike the right balance.

The public policy question is what if any of these or other program changes can be effected without putting the integrity of the Loan Guarantee Program and the small businesses it serves at undue risk. As we attempt to make that judgment, we must remember that deficit reduction is not our only goal. The suggested changes may, in fact, not be compatible with the objectives of equal or even greater importance to this administration: Eliminating the credit crunch which has plagued small business for so long, and allowing small business to be the catalyst for growth it has the potential to be.

If the recommended approach is not compatible with those goals, we must seek a better way. The fundamental question, then, is the impact on the small business borrower. As our committee considers the impact of fee increases and guarantee reductions, we need to ascertain just what such changes would do to those small business borrowers who need this loan money the most.

My concerns focus particularly on those who already have an especially difficult time obtaining credit, the small borrower who needs only $30,000, $50,000, or $60,000, the minority borrower and the emerging business owner. I am hopeful that we can find other sources than the SBA budget for achieving the necessary deficit reduction.

SBA cannot be expected to bear the brunt of this challenge. But if not, then we must seek changes that will not impair the fundamental integrity of our programs.

When we conclude today's hearing, I hope we will have received objective, professional judgment from our expert witnesses on these very important questions. I would like to call upon our distinguished ranking minority member, Mrs. Meyers, for any opening remarks she might make.

[Chairman LaFalce's statement may be found in the appendix.]

Mrs. MEYERS. Thank you, Mr. Chairman. In the interest of time I am not going to make a lengthy opening statement. Thank you for

assembling these many able witnesses this morning to testify and render their opinions on the administration's proposed fiscal year 1994 budget for the Small Business Administration.

As we heard last week from our new administrator, Erskine Bowles, the administration would like to make some changes in the SBA loan programs, most notably the 7(a) General Business Loan Guarantee Program to reduce the taxpayers' exposure, reduce loss rates and provide more loans per appropriated dollar. These changes include reducing the Government guarantee level from an average of 81 to 75 percent and charging a .05 percent fee on the unpaid guaranteed principal balance for sales of loans in the secondary market. Such proposals are not necessarily new, having been put forward unsuccessfully by previous administrations. However, I believe we ought to carefully consider these proposals, and the input of our witnesses, to determine whether such initiatives could be implemented without imposing further harm to the small business lending climate.

In addition to the 7(a) Program, we will hear from knowledgeable witnesses on the proposed funding levels for the 502 and 504 loan programs, the Small Business Investment Company Program, the Small Business Development Centers, and the many other outreach and business assistance programs conducted through the SBA. I look forward to all of your testimony, as it will be very helpful to this committee in assessing the SBA budget. I might say that I was very pleased that the House passed a $181 million appropriation for guaranteed loan money yesterday.

I hope the Senate acts today so that we can get it on the President's desk as fast as possible. Thank you very much, Mr. Chairman.

[Mrs. Meyers' statement may be found in the appendix.]

Chairman LaFalce. Ms. Margolies-Mezvinsky.

Ms. Margolies-Mezvinsky. I know you are as pleased as I am that the funding for the SBA 7(a) loan has been restored by the House of Representatives. On Monday I met with the Key Stone group in my district. They let me know how crucial this money is to them and many small businesses in Montgomery County, Pennsylvania, which is where I am from.

Now, if the Senate follows our lead, this new money they will be able to make loans to small companies, companies which will use the money to create jobs which, as we all know, our Nation desperately needs. We cannot have a jobless recovery. I look forward to today's hearing and learning more about the SBA's 1994 funding needs and program usages. Thank you very much.

[Ms. Margolies-Mezvinsky's statement may be found in the appendix.]

Chairman LaFalce. Thank you very much.

Gentlemen, we have two panels today, and, therefore, of necessity each witness will have to confine his or her remarks to approximately 5 minutes or so. Now, I am not going to be strict about that, but if you go much beyond that, I will have to get a little stricter than I like to be.

Let us hear from our first panel and we will go in the order that you are seated. OK, first we will hear from Mr. Anthony Wilkin-

son, then Mr. John Shivers, Mr. Scott Wilfong, Mr. Kenneth Lueckenotte, and Mr. Kadison.

Mr. Wilkinson, representing the National Association of Government Guaranteed Lenders.

TESTIMONY OF ANTHONY R. WILKINSON, PRESIDENT, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS, INC.

Mr. WILKINSON. Mr. Chairman, I appreciate the opportunity to again come before this committee and discuss the SBA loan programs, the administration's budget request for fiscal year 1994, and the current funding crisis. First, let me start by congratulating President Clinton for his selection of Erskine Bowles as Administrator of the SBA. I have met with Mr. Bowles and I believe he will prove to be an excellent advocate for small business.

Second, let me congratulate the Chairman, Neal Smith, and the other Members of this committee and of the House of Representatives for passing H.R. 2118 yesterday. While I don't understand how the small business sector could ever be subjected to this kind of capital stoppage, the House has taken a major step in rectifying the situation.

I hope that the Senate will move expeditiously to pass this bill and let us get back to the business of serving the long-term debt capital needs of small business.

In terms of the 1994 budget request, let me begin by thanking you, Mr. Chairman, and other members of this committee for repeatedly rejecting the budget proposals over the past 12 years that would have served to make credit more expensive and less available for small business.

Since this budget proposal has simply been repackaged from prior years, I hope this committee will make 13 a lucky number by again rejecting those proposals. While deficit reduction is an issue. the SBA cannot be expected to bear a disproportionate burden in balancing the Federal budget through reductions in its programs. You have my written testimony for the record so in the interest of time I will summarize my presentation.

NAGGL is disappointed that the administration's budget request outlines proposals that serve only to heighten the effects of the credit crunch. The budget request has two line items of particular concern: The decrease in the average guaranty percentage and collection of a secondary market fee at a half percent per annum.

Reductions in the guaranty percentage will simply serve to reduce capital availability to small business. Banks and other lenders simply have limited resources that can be placed in a portfolio of long-term loans, the kinds of loans most needed by small businesses. A reduction in the guaranty percentage leads to a reduction in the availability of long-term loan funds.

Under this scenario, many worthy small borrowers would not have access to needed long-term financing, again heightening the effects of the credit crunch. The budget proposal indicates the guaranty percentage decrease would lead to better lender scrutiny, lower defaults and lower loan losses.

I believe that the SBA loss rate is already sufficiently low. The proposed reductions in the guarantee percentage would only serve

to exclude otherwise worthy borrowers from obtaining credit and would disproportionately impact smaller lending institutions. NAGGL urges this committee to oppose any effort to decrease the guaranty percentage.

The second initiative of collecting an ongoing user fee of half percent per annum runs contrary to the reason the secondary market was established. The secondary market for SBA loans has proven to be an excellent vehicle for small businesses to access capital markets, yet the budget proposal would serve to penalize borrowers and lenders who would access it. Ironically, Mr. Chairman, while you and other Members of Congress search for ways to expand secondary market capital accessibility, the administration has brought forth a proposal that could constrict a secondary market that is working quite well. NAGGL urges this committee to oppose the secondary market user fee.

The two proposed budget initiatives would translate into a significant increase in the cost of the program to borrowers and lenders. The results would include smaller, more difficult and more expensive loans would not be made, meaning the borrowers who need the program the most would go unserved.

Banks' gross revenues would decrease on average 35 to 40 percent, causing lenders to reconsider their use of the program. The revenue cut would result in lower tax payments by lenders. A borrower's cost of capital would be increased to offset the new changes. If we are trying to foster growth in the small business sector, why are we proposing to raise their cost to obtain capital and limiting the use of the program by lenders?

On many occasions the President has talked of the extreme importance small business plays in our economy. He has talked of the need to solve the credit crunch. Unfortunately, the message was either not conveyed to or heard by the budgeters. How can we talk of increasing the flow of capital to small business while at the same time proposing to cut the single largest provider of funds. I know that the administration gave the SBA budget only a cursory review. I believe that the small business sector deserves better treatment than that and I hope the administration will reconsider their budget proposal.

Before any decision is made on structural changes to the program, I would suggest that the subsidy model be carefully reviewed as NAGGL believes there are flaws in the calculation. The subsidy model is overstating the cost of the program to the Government by continuing to fictitiously accrue interest on loans in liquidation.

At charge-off date, the SBA charges off both principal and interest, even though the interest portion does not require a true outlay of funds. This overstates the actual losses incurred by the Government and negatively impacts future users of the program by reporting a higher than actual subsidy rate.

In the private sector, lending institutions are required to place reasons on nonaccrual status when the loan becomes 90 days delinquent. After a loan is liquidated the private sector only charges off the remaining principal balance, as no further interest is accrued. The SBA should modify their accounting practices to reflect this lending industry standard and begin placing defaulted loans on nonaccrual for accounting purposes at the date they repurchase the

guaranteed portion. This will more accurately reflect the Government's required outlays and will reduce the subsidy rate for this most important program.

There are other areas of concern in the subsidy rate. Rather than get into those technical issues here I will correspond with you, Mr. Chairman, and the SBA to make sure that a fair Governmental cost is being reported. It is obviously in the administration's, the SBA's, and the small business sector's best interests to have cost overstating items adjusted before the small business sector is subjected to unnecessary structural changes that would increase their cost of capital.

The administration's budgets request has only addressed the outlay side of the equation. Where is the discussion about the revenues these small business borrowers create? Any good business decision is based upon a cost benefit analysis, not just a cost analysis.

Mr. Chairman, as you have said at past budget hearings, if the Government's analysis were to include the payroll, individual and corporate tax revenues generated by SBA borrowers, you would find that the benefits created by this program significantly outweigh its cost. Ironically, the budget proposal that is supposedly designed to save money for the Government will, in my opinion, lead to larger budget deficits as small businesses will find it increasingly difficult to finance their operation.

The Government coffers would lose tax revenues from those small businesses that could not start, expand or grow because they could not find financing. Borrowers looking for smaller loans that are typically more risky and more expensive will find themselves squeezed out of the program.

With all the foregoing in mind, NAGGL urges this committee to keep with its past convictions and oppose the proposed structural changes to the program that would serve only to restrict capital availability to small businesses and in my opinion increase the Federal deficit.

Earlier this year the administration, in conjunction with the Federal banking regulators, unveiled a program of regulatory and administrative changes that are to help the flow of credit to smaller enterprises. These new guidelines allow well-managed and adequately capitalized institutions to create a loan pool of funds of up to 20 percent of their capital, and these loans would require only minimal documentation.

Unfortunately, this program is not of the magnitude needed by small business, and does not match the effectiveness of the current SBA Program. From the Interagency Initiative/SBA Portfolio Comparison that accompanies my written testimony, please notice that the amount of funds in lender's interagency loan pool correlates to on average to about 2 percent of their loan portfolios. Not a very big leverage. Rather than generating new loans to small business, the bankers I spoke with see this as a safety outlet to reclassify those performing loans already on their books that have been previously criticized by the bank regulators.

This initiative will not result in the kinds of new loan volume as has been stated and will not have the impact that an SBA lending division could have on the bank and the small business community.

In my opinion, the SBA loan programs are well managed. These programs level out the playing field for smaller companies by providing them the same access to affordable, long-term credit enjoyed by larger corporations. This is done at a minimum of Federal cost and at a minimum of interference in the free market system. NAGGL commends the committee for its past support of the SBA and its loan programs and we urge increased support now as the small business sector plays a most important role in these economic times.

We must find ways to encourage the entrepreneurial spirit, encourage people to go into business and create jobs, develop technology, employ people, and generate tax revenues. Restricting small businesses access to capital or raising the cost of capital would be counterproductive.

Let's give Erskine Bowles the tools he needs to succeed. Let's reject the budget proposal, clean up the subsidy rate issue and fund this program as it deserves to be funded. Please keep in mind that ending the small business credit crunch will go a long way toward solving the deficit reduction problem.

As they say in business, you have to spend money to make money. On behalf of the directors and members of NAGGL, I want to thank you for the opportunity to again come before this committee.

Mr. Chairman, NAGGL pledges its active cooperation in working with you and members of this committee on small business financing issues. Thank you.

[Mr. Wilkinson's statement may be found in the appendix.]

Chairman LaFalce. Thank you very much, Mr. Wilkinson.

Our next witness will be Mr. John Shivers, Chairman, President and CEO of the Southwest Bank, Fort Worth, Texas, on behalf of the Independent Bankers Association of America.

TESTIMONY OF JOHN SHIVERS, CHAIRMAN, PRESIDENT AND CEO, SOUTHWEST BANK, ON BEHALF OF INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. Shivers. Thank you, Mr. Chairman. As stated, I am John Shivers from the great State of Texas and I represent the Independent Bankers Association of America, the only trade association that exclusively represents the interest of our Nation's community banks. I appreciate this opportunity to testify before you today on SBA's budget request for 1994.

Before I begin I would like to commend you and your committee, Mr. Chairman, for the work you have done in the area of the credit crunch. These hearings highlight the critical connection between overly burdensome bank regulations and restricted access to credit for small business. President Clinton and Federal Reserve Chairman Greenspan also recognize the importance of alleviating the credit crunch by scaling back bank regulations.

On March 10th, Mr. Clinton announced a package of initiatives designed to stimulate lending, especially to small- and medium-sized businesses. We believe the President's plan is helpful and will encourage increased small business lending, but the success of the

program will depend largely on balanced implementation by the regulators.

As you know, regulatory relief is not always determined by what officials say in the Nation's Capitol, but regulatory relief is measured by what the examiners do when they visit our institutions. It will take time for the regulators and the banks to implement these new policies and to realize the intended goals of increased lending.

We understand that Eugene Ludwig, the new Controller, is currently visiting all the field offices to ensure the examiners get the word. The President's credit crunch initiatives are a vital first step, but they are obviously that, a first step. Earlier this month before this committee, Chairman Greenspan urged Congress to consider legislative proposals for regulatory burden reductions to be announced later this spring by the FFIEC. Clearly regulatory relief is possible without compromising safety and soundness.

Overregulation of banks has forced caution on the banking industry. The SBA guaranteed loan program is allowed a considerable number of banks to continue making job-creating loans. During this credit crunch, demand for SBA loans has skyrocketed, completely depleting available funds. As you know, the SBA 7(a) Program been paralyzed since April 27 and desperately needs the additional funding.

I am certainly glad to hear that H.R. 2118 passed last night, to provide $181 million in supplemental SBA appropriations for fiscal year 1993, which would be leveraged into $3.3 billion in available loan funds. It is ironic now that there is widespread recognition that small businesses are a primary source of job creation, one of the most accessible and efficient sources of small business funding has been shut down.

Mr. Chairman, let me give you some cold, hard facts. Liberty National Bank, an IBAA member bank, recently named as the top SBA lender in Florida, has provided over $20 million in SBA loans to 70 businesses in central Florida over the past 3 years. These loans resulted in the creation of hundreds of jobs.

Examples include: $35,000 to startup a marketing company that now employs 30 people; $75,000 to startup a restaurant that now has 30 full-time employees and is planning a second location; $60,000 to startup a personnel company that led to the creation of over a 100 new jobs. The list goes on and on, but the point is that none of these companies would have received financing were it not for the SBA Loan Program.

As demand for SBA loans continue to grow from $5.6 billion in 1992 to an estimated $7 billion in 1993, scaling back funding for the program in the 1994 budget would be unwise.

The SBA loan program is both efficient and cost-effective. The funds appropriated for this program are used to leverage private sector money at the rate of nearly 20 to 1. While SBA guarantees only a portion of the loans, the loans are made and serviced by lenders in the private sector. The Government gets an enviable return on this investment.

President Clinton's budget makes two recommendations for savings. First, the proposal to reduce the guaranteed loan from an average of 81 to 75 percent. This reduction is intended to shift a greater degree of risk to the lenders, thereby increasing scrutiny of

loans and reducing the default rate. However, the practical affect of this change in the guarantee levels would be to drive deserving credits out of the SBA system altogether. These are small loans to startup businesses that are difficult for banks to make, but are critical to new job creation. In addition, reducing the guarantee level would lower the amount a bank could lend a single customer.

The second administration proposal is to charge a 50 basis point fee on the unpaid guaranteed principal balance for sales to the secondary market. This uniform fee would discourage smaller working capital loans. High volume participants in the small business secondary market would simply pass any additional fees on to borrowers. Again, this proposed savings would only serve to reduce lending by increasing the cost.

Time has proven the value of the SBA Program in providing small businesses with easier access to capital in putting people to work and generating more tax revenues for the Government.

The SBA is important to community banks as well. In addition to fostering a general improvement in their local economies, it provides bankers with a new source of dependable customers which tends to create long-term relationships and many of these loans are made to members of disadvantaged groups, helping banks to meet their Community Reinvestment Act commitments. Cutbacks in SBA guarantee level will hurt these kind of borrowers.

In conclusion, Mr. Chairman, we strongly urge you and your colleagues to provide not only supplemental funds needed, but to adequately fund fiscal year 1994. We also recommend rejecting the administration's budget proposal to lower the guaranteed level and impose a secondary market fee, both of which would severely impede the success of the SBA Program. Instead, we encourage your support to maintain the existing program as a critical element in supplying the credit to the Nation's small businesses. We believe that a strong SBA guaranteed loan program is vital to ensuring the viable small business prospers and rural development efforts are successful.

Mr. Chairman, thank you once again for this opportunity to testify. At the appropriate time I would be happy to answer any questions you may have.

Chairman LaFalce. Thank you very much.

[Mr. Shivers' statement may be found in the appendix.]

Chairman LaFalce. Our next witness, Mr. Scott Wilfong, senior vice president, First National Bank of Maryland In Baltimore, on behalf of American Bankers Association.

TESTIMONY OF SCOTT WILFONG, SENIOR VICE PRESIDENT, FIRST NATIONAL BANK OF MARYLAND, FOR AMERICAN BANKERS ASSOCIATION

Mr. Wilfong. Good morning, Mr. Chairman, members of the committee, I am Scott Wilfong, senior vice president, First National Bank of Maryland in Baltimore. I am responsible for overseeing our bank's small business lending division and I am a member of the American Bankers Association's Small Business Executive Committee. I am here not only to voice strong banking industry support for the Small Business Administration's current guaran-

teed lending programs, but also to express ABA's appreciation for the Chairman's leadership and this committee's continued support for Small Business Administration Programs.

In the interest of time, I will summarize my written statement provided to the committee. Mr. Chairman, the ABA is very concerned about the effect the SBA's budget request for fiscal year 1994 will have on the ability of marginal small business borrowers to receive credit. For years the banking industry has been a major participant in various SBA Programs. Approximately 10,000 backs have been involved in the SBA loan programs. A primary example is the Loan Guarantee Program which is authorized by section 7(a) of the Small Business Act of 1953. This program benefits the national economy and individual communities through the jobs created and revenues produced by small businesses involved in the program.

As you are well aware, small businesses employ 60 percent of the private work force in this country, and in recent years has accounted for nearly all the economy's net job growth with most of the new jobs being created by firms with fewer than 20 employees. Because small businesses in general have limited access to capital markets and other alternative sources of credit, they are likely to be more dependent on banks to fund their operations. The Small Business Administration's loan guarantee program is an extremely important tool which enables commercial banks to assist all eligible startup companies and expanding companies that desperately need financing but are unable to qualify for traditional bank credit.

It is important to understand why the SBA loan guarantee programs are important to the commercial banking community. Like other businesses, banks must be able to meet their customers' needs if they are to survive. Equally important, however, is the fact that bankers must continue to be careful to evaluate the quality of loans they make rather than simply push money out the door. Banks must continue to lend on the basis of what can be reasonably foreseen based on cash-flow projections. While bankers are committed to the economic vitality of their communities, particularly small businesses, their banks must continue to operate within the parameters of safety and soundness laid out by the regulators.

Consequently, one way for banks to participate effectively in sound small business projects that lack the resources and credit history to qualify for a traditional bank loan is to work with Government programs such as the SBA 7(a) Program.

As you are well aware the demand for 7(a) loan guarantees consistently outstrips the allocation of guarantee authority that the Congress has provided for these loans. In fact, the guarantee funds for fiscal year 1993 were exhausted in late April.

In this regard the ABA appreciates the efforts of the Chairman and the committee members who requested and supported the $181 million in additional SBA guarantee funding included in the House Appropriations Committee's supplemental appropriations bill. This vital funding will result in an additional $3.3 billion in loans to small businesses. It is our hope that this funding will move expeditiously through the Senate and be signed by the President in the very near future.

This supplemental appropriations bill will enable the Federal Government to mobilize a force of banks to offer otherwise unavailable loans to small businesses. For local communities, this means jobs, economic development, an increased tax base, and perhaps survival of the community. Everybody wins.

This brings me to the proposed program changes requested by the Small Business Administration for fiscal year 1994. ABA is concerned about the unforeseen effect these changes will have on small business lending, and therefore is opposed to them. More specifically, the ABA is opposed to the proposed reduction in the Federal guarantee from an average of 81 percent to an average of 75 percent. In addition, the ABA is opposed to the proposal to establish an ongoing fee of one-half percent per year on the unpaid guaranteed principal amount on all secondary market sales.

Taken together, these two proposals will result in fewer loans being made to those who need the funding the most, marginal and startup small businesses. This proposal, if accepted, will undermine the effectiveness of the additional funding authority for SBA Programs for fiscal year 1993, currently moving through Congress. It would send a mixed signal to the lending community about the types of loans being sought by the SBA for the guarantee program.

Last week SBA Administrator Erskine Bowles made the following statement before this committee in support of the reduced guarantee level: "This means that lenders participating in the general business guarantee loan program will be required to assume a greater share of the risk in making loans to small businesses. Requiring lenders to assume a greater share of the risk will increase their scrutiny of potential borrowers, thereby reducing the default rate and increasing the recovery rate on repurchased loans."

If the purpose in reducing the average guarantee level from 81 percent to 75 percent is to increase the credit risk scrutiny of potential borrowers, the result represents a confusing policy and a mixed message, hindering effective participation in SBA Programs by bankers and borrowers alike. Bankers currently look to the SBA to help them assist marginal small business borrowers who are not presently creditworthy, but with proper assistance, have the potential to succeed.

By mandating a transfer of additional risk from SBA back to the lender, the SBA, in essence, is stating that it is looking for more creditworthy borrowers. This would suggest the SBA is moving further away from its original purpose of helping undercapitalized small business ventures and instead is more interested in bank eligible credits, many of which are currently being funded by the Banking community without the guarantee.

Although some SBA guaranteed funding would still be utilized at the reduced level, those marginal small businesses, the ones most in need of SBA funds, would be most likely not be the ones to receive credit under this structure. It is for these types of loans that the lending community turns to the SBA for assistance in the first place.

Mr. Chairman, for basic safety and soundness reasons, increasing the amount of risk a lender must assume on a marginal small business loan could well mean that the new startup business loan that would have been made today with the help of a SBA guarantee

may not be made in the future. A commercial bank's job is to assess the credit risk of a borrower by closely examining the borrower's business, management ability and financial needs in an effort to determine reasonable cash-flow projections.

The bank's methods of assessing this risk are being closely examined by the regulators. Loans lacking proper collateral, adequate source of repayment, and established business history, are often classified as substandard by the regulators unless they are accompanied by sufficient Government guarantees.

Reducing the guarantee level in these undercapitalized loans will increase the risk of exposure to the lender. Although the reduction doesn't seem significant on the surface, the increased exposure to the lender could result in the unguaranteed portion of the loans being classified. In turn, this would result in requiring banks to hold additional capital against greatly increased credit exposure. More than likely, the end result would be that these types of loans to marginal small business borrowers could significantly be curtailed.

Let me give you an example of the type of loan that would have difficulty being made under this proposal. In 1989, my bank made a $90,000 loan to a gourmet coffee shop here on Capitol Hill. This promising new business needed funding for equipment purchases, leasehold improvements and working capital. Not only was this a risky startup venture, the three women owners had no previous experience in operating a business and the financial analysis projections were very tight. Because of these risks, the deal required a 90 percent guarantee on the part of the SBA. Even with the 90 percent guarantee, the deal was considered risky.

Fortunately, the business is successful today. However, if the guarantee levels were lowered, it is highly unlikely that a similar loan could be made today.

The proposal to reduce the average guarantee levels——

Chairman LaFalce. Wouldn't you have made it with an 85 percent?

Mr. Wilfong. Probably not.

Chairman LaFalce. Really.

Mr. Wilfong. Probably not. It was difficult at the 90 percent.

Chairman LaFalce. Do you think if it shopped around it would have found some bank that would have made the loan at an 85 percent guarantee?

Mr. Wilfong. Mr. Chairman, our bank is a preferred lender and we could have done it under our preferred lender status at 80 percent. Went to the SBA and requested that we do it outside the preferred lender status under the 7(a) Program with a 90 percent guarantee, because we believed in the principles of the company, felt that they had the ability to be able to make it successful but didn't feel it fit under the criteria of the preferred lenders program.

Chairman LaFalce. What percentages of your SBA loans are made as a preferred lender and what percentage of them do you go outside the preferred program in order to get a higher guarantee?

Mr. Wilfong. Probably 90 percent under our preferred lender program, and 10 percent under our higher guarantee level.

Chairman LaFalce. So for 90 percent of the loans, you think that 80 percent is good enough as opposed to a 90 percent?

Mr. Wilfong. Because of the underwriting criteria we utilize for those loans. Our bank's position——

Chairman LaFalce. Please continue. I shouldn't have interrupted you.

Mr. Wilfong. The SBA's proposal to establish an ongoing fee of one-half percent on the unpaid guaranteed principal balance on all secondary market sales would have the same result, reduced credit availability. Additional cost to these transactions always affects the marginal borrower first. No matter how well intended, mandated fees are always passed on to the borrower in one form or another because they are an increased cost of doing business. Those least able to afford it are affected the most severely. Again, some undercapitalized borrowers who would be eligible today for SBA guaranteed funding may not be able to afford it with additional costs as a result of these fees.

In the end, Mr. Chairman, Federal Government has crafted a program that works. Please do not change it. The SBA loan guarantee program's return on investment in terms of creating jobs, establishing long-standing productive businesses, has been more than cost-effective. Ultimately, it is the Government's programs like the SBA that enable lenders to help the marginal borrower.

The SBA has been a blessing for rural communities, for innercity entrepreneurs trying to redevelop neighborhoods, and for small businesses all over America. For these reasons it is our hope that this committee and the Congress will continue to fight efforts to alter the SBA Programs in ways that reduce its effectiveness in aiding marginal small business borrowers.

As always, this committee's continued support for the SBA Programs is certainly appreciated by the banking community. The banking community looks forward to continuing work with this committee and the SBA in a combined effort to assist our Nation's small businesses. I will be pleased to answer questions.

Chairman LaFalce. Thank you very much, Mr. Wilfong.

[Mr. Wilfong's statement may be found in the appendix.]

Chairman LaFalce. Our next witness is Mr. Ken Lueckenotte, president, the National Association of Development Companies.

TESTIMONY OF KENNETH I. LUECKENOTTE, PRESIDENT, AND EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Mr. Lueckenotte. Good morning, Mr. Chairman, and members of the committee, I am Ken Lueckenotte, president of the National Association of Development Companies, and also executive director of Rural Missouri, Inc., a statewide certified development company. I want to thank the Chairman and the committee for your longstanding and generous support for the 503/504 Programs over the last 12 years. I also want to thank you for this opportunity to comment on the fiscal year 1994 budget as well as other issues pertinent to this important economic development program.

Mr. Chairman, as a father of this successful economic development program, you are well aware of its structure and objectives,

but for those of the committee who may not be so familiar, I would briefly like to summarize the 503/504 Programs.

Legislation authorizing the 503/504 Programs was enacted in 1980, creating a public private partnership to provide growth capital to creditworthy small businesses in order to create or retain jobs in both rural and urban communities. Businesses needed a source for long-term financing to better match loan terms with the economic lives of the assets that they were acquiring. Under the program, new and expanding small businesses borrow long-term funds for investment in new commercial construction, plant expansion, and equipment acquisition.

A typical financing package includes a bank loan for 50 percent of the project, and a subordinate U.S. Small Business Administration guaranteed loan for 40 percent. This loan is of a 10- or 20-year fixed rate term, and 10 percent owner investment. A key element of this program is that at least one job be created for every $35,000 of guaranteed funds. There are currently 389 certified development companies authorized by the SBA to process and service these guaranteed loans. Except for about 10 of these companies, the rest are not-for-profit, community-based organizations, economic development authorities, or units of Governments focusing on economic development and job creation programs.

Chairman LaFalce. If I could just interrupt you, I really think the administration would be very wise as they discuss community development banks to look to the certified development companies as an instrument to deliver that service. The CDC Program could be expanded and utilized because it is an existing network in almost every urban and rural community of America right now.

Mr. Lueckenotte. We would agree with you, Mr. Chairman. We did send a letter, I believe, last year to Senator Kennedy requesting inclusion of certified development companies in his bill at that time.

The guaranteed 503 loan was financed through the Federal Financing Bank creating a line item expense in the budget. In 1986 the 504 Program was implemented whereby the guaranteed loan is financed through private capital markets, leaving only the subsidy as a budget item.

Now, for the current budget. The authorized level for fiscal year 1993 is $775 million for 502 and 504 combined. The appropriated subsidy is for $700 million for 504, and $40 million for 502. Through April of this year, authorizations for the 504 Program have totaled $400 million, and based on historical patterns, usage of the program in the latter months of the fiscal year has always been heavier.

We are projecting a need for this year of between $800 million and $850 million just for the 504 Program. With the 504 subsidy rate of. 54 percent, $540,000 would fund $100 million of additional authority, leveraging a total of $250 million for plant expansion. This would create approximately 10,000 jobs based on what has historically been the job creation ratio.

Using the subsidy rate, this would be 1 job for $54 of subsidy. We urge the committee to act quickly to provide the badly needed authorization increase and to support a reprogramming of existing

appropriated SBA funds for the remainder of this fiscal year. I would now like——

Chairman LAFALCE. Let me just say that the committee is very well aware of the need for action by the authorizing committee, this committee, in this fiscal year, and we intend to respond.

Mr. LUECKENOTTE. Thank you, Mr. Chairman.

For fiscal year 1994, over the past 2 years this program has grown at a 25 percent rate each year. While massive job cutbacks are taking place in Fortune 500 companies, loan losses in the 504 Program continue to fall, resulting in a subsidy decrease of .54 percent in fiscal year 1993 to .51 percent in fiscal year 1994. Interest rates are at an all time low of 6.5 percent for a 20 year loan.

Spreads over interest rate for this program have decreased from 150 basis points in 1986 to 60 basis points in the May funding. The administration's request for fiscal year 1994 is $761 million for the 504 Program alone. We are projecting, based again on current year needs and the historical growth, that we will need $950 million in fiscal year 1994 for the 504 Program alone.

At a subsidy rate of .51 percent, this $4.8 million in appropriation would leverage $2.5 billion in plan expansion. At the federally required job creation rate of one job per $35,000, this would create 27,000 jobs. Again, statistics show that over the past 12 years we have created one job per $10,000 of 503 and 504 dollars.

Using this ratio, this $4.8 million in subsidy would create 95,000 jobs. We urge that the fiscal year 1994 502, 504 authorization, be increased from the $825 million to $1.09 billion. We also request that the Congress appropriate fully the amount of subsidy to fund this loan authorization level.

In past years NADCO has testified in support of a solution to the lower interest rate and prepayment premium of the old 503 loans. We applaud the committee's leadership and Congress' and the administration's efforts in seeking a solution. By paying high interest rates when competitors have been able to refinance at current low rates, the 503 borrower is at a competitive disadvantage within their respective industries. We would urge that the committee continue to look into a solution for this problem.

We applaud Administrator Bowles' objectives to improve the agency's efficiency by reducing paperwork and through reorganization.

Two steps that have been taken toward reaching these objectives were the implementation of the Accredited Lender Program in 1991 and centralizing the servicing function, which was recently done for the western region through the Fresno, California office. The Accredited Lender Program is similar to the successful certified 7(a) lender program in that qualified CDC's perform additional duties reducing the work load for the SBA staff.

These efficiencies create an opportunity to redirect staff in areas that will improve the SBA's service to our small business customers.

We are concerned about the reduced budget and staffing proposals for the SBA. Since 1990, over 130 field staff positions in the financial assistance offices have been eliminated. The fiscal year 1994 budget proposes a 12 percent reduction from the fiscal year 1993 budget in the financial assistance area. Loan approvals per

SBA field staff have increased from 45 to 62, and portfolio management work load has increased from $21 to $31 million per SBA FTE.

At a time when we are all trying to do more with less and the demand for the SBA Programs is increasing, we must caution ourselves to not sacrifice quality for quantity. The long run effect could result in greater loss and increasing program costs.

We support the administration's focus on the business customer and hope that the SBA will continue to expand its role in the Nation's economy.

Mr. Chairman, this concludes my prepared remarks. I would be happy to answer any questions at the appropriate time.

[Mr. Lueckenotte's statement may be found in the appendix.]

Chairman LaFalce. All right. Thank you very much. Our final witness on panel number one will be Mr. Douglas Kadison, representing the Savings and Community Bankers of America.

TESTIMONY OF DOUGLAS B. KADISON, CHAIRMAN AND CEO, HORIZON SAVINGS ASSOCIATION ON BEHALF OF SAVINGS & COMMUNITY BANKERS OF AMERICA

Mr. Kadison. Good morning, Mr. Chairman, members of the committee. I am Douglas Kadison, chairman and chief economic officer of Horizon Savings Association. Horizon is a $65 million community institution headquartered in Austin, Texas. I am appearing today on behalf of the Savings and Community Bankers of America, our national trade association, representing more than 2,000 community lending institutions.

While the focus of our industry is naturally on housing, we are full-scale community lenders. At Horizon, we lend to our community to maintain and enhance its economic and social strength.

I welcome the opportunity to share with you some thoughts on our institution's involvement in the Small Business Administration's section 7(a) guarantee loan program. It is a wonderful program and one that I am passionate about. It can be very, very beneficial to a great number of people.

Let me state at the outset how unfortunate it is that the program is currently out of funds. I hope these badly needed moneys will be made available as soon as possible. Horizon is continuing to process small business loans, but because of the outage of SBA guarantees, we are unable to fund new loans.

It is making our borrowers frantic with worry. While some loans can be made without SBA backing, for those loans on the cusp or needing more extended terms, the guarantee makes the extra difference.

Horizon opened for business on May 1, 1987. In the fall of 1991, we became a preferred SBA lender. Horizon was able to accomplish this so quickly because of the technical expertise of our people, the ability to control underwriting exposure, and by demonstrating to SBA our overall competence.

Since we began, Horizon has made over 80 section 7(a) SBA loans. Horizon, in fact, is the only preferred and certified bank or thrift in the Austin area. The average size of a SBA loan made by

Horizon is roughly $270,000. Over 25 percent of our SBA loans have gone to women and minorities.

It may be difficult for me to quantify the number of jobs specifically we have helped to create, but I can tell you about some of the people whose lives have been changed for the better because of our loans. In the San Antonio barrio, a husband and wife ran an ice house, which is, in effect, a corner bar. They were renters and did not own the building where their business was established.

The husband died and the woman, who was in her 40's and raising three children, was left running the place. She was doing this for 7 years until the individual who owned the building decided to sell it. Naturally the woman wanted to buy the building, but who would want to lend to a minority woman who owned a bar in a barrio?

She needed $50,000. To make a long story short, Horizon made the loan and it performed fine until recently when the woman's mother became ill and she had to cover her medical bills. The loan is currently delinquent, but it is still on our books and we are working it out.

We made the loan because it was the right thing to do in every sense and we continue to believe that.

A company that makes memory expansion boards for computers came to us for working capital and equipment loan. Horizon made a SBA loan of $600,000 and in that year the company's sales jumped over three-fold to $6 million, the next year to $18 million, then $30 million, and it is currently expected to hit $60 million. That company, in fact, became an Entrepreneur of the Year award winner. It is great local success story.

One bright guy working for a venture capital company came up with the idea of developing a motion detector that could be placed in warehouses or public restrooms. It would automatically turn on the lights when someone entered and turn them off when the people had left. The firm where this individual worked spent $1 million on the idea, but ultimately decided that the market was not deep enough. The inventor was given his patent and wished good luck.

Horizon has made several SBA loans over time to this inventor. That individual, who began by operating out of his garage, had $1.5 million in sales in his 4th year and now employs 25 people.

A small business, a local merchant in a small town in Texas, found itself struggling to survive after a Wal-Mart moved nearby. The local merchant tried to redirect sales and find a niche, but in the short-term found himself saddled with substantial debt. The merchant came to us for a $120,000 loan to pay off the accounts receivable, consolidate debt and take steps to survive. They have made progress. They have a real good chance to succeed.

The story is not unique. A small woman in her early-to-mid-30's ran a dog grooming business in rented space. A building came up for sale in her neighborhood, which also offered her the opportunity to put boarding kennels in the back. Horizon made a loan of a $125,000 to her to buy the larger space.

The woman turned out to be a typical small business borrower. She knew how to groom dogs, but she was not the world's greatest businesswoman. She had some cost overruns in buying and setting

up her new property. She ultimately filed for bankruptcy, but the woman said she was going to work things out and we believed her.

She has reaffirmed her debt and the loan is now performing. Admittedly not all of our SBA loans are wild success stories.

Texas has gone through some tough times the past 6 or 7 years, but we can proudly say that we were in the market making good loans when no one else would and the vast majority have and continue to perform as agreed. Horizon sells all of its loans to the secondary market in order to relend the money to other small businesses. The administration's proposal to charge an ongoing fee on secondary market sales would reduce profitability of small business lending to the bank.

When combined with the proposed cut in the guarantee percentage, SBA lending will be considerably less attractive. Also, because of the increased long-term risk exposure, there will be a reduced number of institutions who participate in the program.

While many of the administration's initiatives to control Government spending are laudable and we are all committed to deficit reduction, there is an overriding imperative to stimulate the economy and create jobs. The SBA loan program has been successful and should be an integral part of the administration's proposed community development and empowerment zone initiatives.

Horizon's work with minority individuals has not stopped with SBA loans. Last June, Horizon invited all the small lenders in town to join us in forming a cooperative to pool our resources and to potentially share the risk of lending to low-income borrowers. Further, with this group's combined resources, we have been able to hold outreach seminars on an ongoing basis in minority communities.

Topics have included how to balance a checking account, documents needed to apply for a business loan, how to prepare a balance sheet, and the nature of SBA loans and the application process.

Mr. Chairman, I am an old liberal from the 60's. SBA loans feel good to make, do good in the community, and can be profitable. The program needs funding to continue. Savings and Community Bankers of America appreciates the opportunity to share our thoughts and experiences with your colleagues and you.

I would be happy to answer any questions later.

[Mr. Kadison's statement may be found in the appendix.]

Chairman LaFalce. Thank you very much. I will defer my questions until the end.

Mr. Bilbray?

Mr. Bilbray. I have no questions.

Chairman LaFalce. Mrs. Meyers.

Mrs. Meyers. Could any of you give me a breakdown of how many small business loans you or your members make without the 7(a) guarantee?

Mr. Shivers. Mrs. Meyers, my bank in Fort Worth, we make quite a number. We do use SBA system for the more riskier loans or the ones like Mr. Wilfong mentioned. There are some, especially on new businesses, that are starting out that Mr. Johnson well knows in the greater Metroplex area. We have had a number of layoffs, especially at General Dynamics.

In their outplacement, they suggested these engineers and so forth, aerospace engineers, you need to go out and start your own business. That is very risky, lending to somebody that has absolutely no background or experience in a particular type of business. Those types that we look to the SBA for and many of them are very, very close calls.

Mrs. MEYERS. Do you have any kind of a percentage estimate, Mr. Shivers, as to what percentage with and without the 7(a) loan?

Mr. SHIVERS. If they have no experience, we would have to use SBA.

Mr. WILKINSON. If I could add to that, there are probably different types of loans that are being made. I don't know much about his institution, but at the bank I was at, we would not make long-term loans based on our short-term deposit base. We would use the SBA Program for the loans that needed the longer terms. We were actively involved in making loans to small businesses. Without the SBA, but they were typically only up to 3 years in maturity.

But the SBA guarantee provides you the mechanism to make the longer term loan that the small business needs. I believe it was 1983 the GAO study was done, said 40 percent of all long-term financing was done through the SBA and my guess is it is a significantly higher number today.

Mrs. MEYERS. Mr. Wilfong, in——

Chairman LAFALCE. Ninety percent?

Mr. WILKINSON. Yes, sir.

Mr. WILFONG. In terms of our total loan portfolio, I could get that information back to the committee, but we tend——

Chairman LAFALCE. Please do so, yes.

Mrs. MEYERS. I think we would be interested in that.

Chairman LAFALCE. It is Mrs. Meyers' time but I will extend it.

Mr. BILBRAY. I was asked, I had no questions, but on following up this line, if the lady will yield, have you had any problems with the regulators on—we had some problems in Nevada where banking regulators were saying that banks were required to reserve the full amount of money SBA guaranteed loans.

Have you had any problems on that at all?

Mr. WILKINSON. Significant troubles. We have been working with the Federal banking regulators from accounting issues to the perception that all SBA loans are junk. I think we are making some headway, but——

Mr. BILBRAY. Even the ones that are guaranteed, they are still doing it?

Mr. WILKINSON. We have had several institutions who had their entire SBA portfolio classified simply because they had the SBA guarantee.

Mr. BILBRAY. Mr. Chairman, this is what I brought up last time.

Chairman LAFALCE. I thought we had changed that. Point number one, the SBA guarantee automatically means you don't have to hold capital against it. Point number two, most often that SBA guarantee, particularly for your smaller banks that are having difficulties, is sold off in the secondary market, leaving you with the 10 percent, and some lenders actually are looking at pooling together their unguaranteed portion and selling that in the secondary market, too.

There is a totally new regulatory climate today. It is 180 degrees. Gene Ludwig has come in as Comptroller of the Currency and he is a dedicated public servant and wants loans made. That is going to take time to get down to the community, but it is going to happen.

John Fiechter, over at OTS, just had a meeting with around 300 examiners of OTS, and he told them that previously, OTS usually gave examiners bonuses for closing down institutions, but that is out. Today, OTS will give you bonuses for keeping them alive. A total reversal.

The President is probably going to appoint shortly, as chairman of the FDIC, Chris Gallagher, the general counsel to the New Hampshire Bankers Association, who as counsel to New Hampshire Bankers Association experienced the credit crunch, the regulatory crush, and railed against it.

That is the reason that President Clinton is probably going to appoint Mr. Gallagher. So I think you are going to see a 180 degree reversal in the regulators' perspective with respect to——

Mr. FLAKE. Will the gentleman yield?

Mr. BILBRAY. The gentlelady has the time.

Mrs. MEYERS. Yes, I would be happy.

Chairman LAFALCE. The gentlelady will be given at least an additional 5 minutes.

Mr. FLAKE. Thank you very much, Mr. Chairman.

I am a strong supporter of this administration, and I agree with you that there are a lot of positive changes coming about. However, I agree with the gentleman from Nevada in that there are persons who have SBA guarantees and the banks have not been able to make loans simply because they say the regulators have placed some onerous burdens on them.

So the question is really not where we go in the future, but how do we get movement right now we need to expedite regulators' responses to what are some very critical situations where a person's business is on the brink of either closing or staying alive on respirators. I have at least three cases that I am working on at this very moment where SBA is not the problem, but the banks say they cannot make the loan.

I think we need to be open to the reality that there must be some way to assure that businesses that have been doing well, are relatively profitable, and have been able to sustain themselves in spite of a lack of capital, can move toward receiving credit. It seems to me that if SBA is giving the guarantee, there is no reason for a bank to withhold the loan.

[Mr. Flake's statement may be found in the appendix.]

Chairman LAFALCE. I really think that 99 percent of the time, that is the case. I would also note the tremendous increase in demand for SBA guarantees. Very often now you can't get a loan without an SBA guarantee. If someone wants a loan for a restaurant business, it is not available today without an SBA guarantee.

Maybe the committee should adopt a new policy and advise lenders that they will put a price on the head of any examiner who is deemed to be discriminating against an institution simply by virtue of the fact that the lender has obtained an SBA loan guarantee. But now, let's return to more normal order.

Mrs. MEYERS. Mr. Shivers, in your written testimony you provide an example of three loans that one of your member banks in Florida was able to make with the 7(a) Program that it would not have been able to make otherwise. They were for relatively small amounts, $35,000, $75,000, and $60,000.

All resulted in getting highly successful small businesses off the ground. Collectively, I believe you credit them with creating over 180 new jobs. Now, why couldn't this bank take any risk on those small businesses without the 7(a) loan guarantee?

Mr. SHIVERS. Mrs. Meyers, this bank is only a small bank of $33 million in total assets, so they have really used the SBA Program to take care of their community needs and the needs of their borrowers in their area. So with the guarantees, this allows them to make much larger loans than they would normally be and much more loans that does not count against their capital.

Mrs. MEYERS. What size did you say the bank was?

Mr. SHIVERS. We have $33 million in total assets.

Mrs. MEYERS. Well, I thank you very much, Mr. Chairman, and I yield back the balance of my time.

Chairman LAFALCE. Mr. Flake, do you have any questions?

Mr. FLAKE. Yes, Mr. Chairman. First of all I ask unanimous consent to have my written statement placed in the order.

Chairman LAFALCE. Without objection, so ordered.

Mr. FLAKE. Thank you. As we move forward in the process of trying to create a community development banking entity or program, I would ask the panel if they have any ideas relating to SBA's role. What role do you see the SBA playing and how do we ensure the best possible delivery of credit into communities? Specifically refer to delivery in those communities that are underserved. In general, how do we actually build a program that can have the benefit of SBA guarantees and also be in a position to help us to rebuild what I consider to be the Third World nation within America's borders?

Mr. KADISON. Personally, I think the suggestion of using the local CDC is——

Mr. FLAKE. Please speak into the microphone.

Mr. KADISON. I am sorry. Using the local CDC's, which are already an existing arm that are down in the community, is the logical starting place. I know they started a micro loan program——

Chairman LAFALCE. Section 503 and 504 Programs I think is——

Mr. KADISON. Where you are getting circles of people involved together to work together, that are the borrowers. I think it is just a matter of getting something started. I mean whatever you start with probably isn't going to be perfect, but it will evolve.

Mr. FLAKE. Would those CDC's be eligible for SBA guarantees?

Chairman LAFALCE. We presently have CDC's, about 400 certified throughout the country, in every urban and rural community in America. They do have SBA backing. They carry generally an SBA guarantee on 40 percent of the cost of the project being financed. Mr. Lueckenotte represents the National Association of Development Companies who represents most of these CDC's and programs. You could explain what a 502, 503, and a 504 Program is. I think it would be helpful.

Mr. LUECKENOTTE. OK. Thank you, Mr. Chairman.

Mr. Flake, a 502 Program is a loan guarantee program where in rural communities up to a 90 percent guarantee can be obtained for financing fixed assets. In urban communities the guarantee is limited to 40 percent under the 502 Program. In the 504 Program, Certified Development Companies, are responsible for packaging, processing, closing, and servicing SBA guaranteed loans for up to 40 percent of a fixed asset project with a maximum loan by the certified development company of a million dollars. Banks or other entities are required to also provide part of the financing.

A typical structure would be where a bank finances 50 percent and there is at least 10 percent investment by the owner. We can finance these projects for a 20-year term on our portion and we require that the banks provide at least a 10-year term. In many cases they go longer. We have looked at the Community Development Bank Program and have made recommendations that Certified Development Companies who have been doing business lending since 1980 be eligible to receive those funds.

Over the 12 years, we have financed over $3 billion worth of business development just with our 40 percent portion. So, as you can see, we have leveraged well in excess of $7 billion of fixed asset growth over this 12 year period. The national average has been that we have created one job per every $10,000 of the SBA guaranteed portion.

Mr. FLAKE. My only concern is that the 40 percent threshold may be relatively low when trying to rebuild many of those commercial strips while at the same time getting small businesses started in those areas.

Mr. LUECKENOTTE. The 40 percent guarantee is in the urban areas in the 502 Program. In the 504 Program where we have a bank involved and financing part of the fixed asset cost, the bank obtains a first mortgage or first lien on the assets being financed. The loan that the Certified Development Company makes to that business is a separate loan from the bank loan and we have 100 percent guarantee from the SBA and are behind the bank in collateral. So it makes the bank's loan a fairly secure loan.

Mr. FLAKE. Thank you very much. I yield back, Mr. Chairman.

Mr. WILKINSON. If I might add one quick comment, I am not an expert on the Community Development Bank issue, but the Chairman of the NAGGL Board of Directors is an individual by the name of Richard Turner who is from the South Shore Bank in Chicago, and I will be happy to have him get in touch with your office to work through how the 7(a) Program could be instrumental.

Mr. FLAKE. I would be happy to. Thank you very much.

Chairman LAFALCE. Mr. Johnson.

Mr. JOHNSON. Thanks.

I would just like to say that we have got two neat guys from Texas here and I think I should recognize them. I happen to know one of them pretty well and I thank y'all for your testimony.

Mr. Kadison, I wonder, are you a savings and loan association?

Mr. KADISON. Yes, we are.

Mr. JOHNSON. The only one left in the State?

Mr. KADISON. Damn near.

Mr. JOHNSON. Do you know how many of your loans are small business loans?

Mr. KADISON. In our particular case, we have made it a strategic plan, to operate like a small town community bank, even though Austin is a fairly large city.

Mr. JOHNSON. Well, were you operational before the savings and loan crunch?

Mr. KADISON. We opened as a new charter on May 1, 1987. We opened right in the middle on the way down. We looked at ourselves at our first meeting.

Mr. JOHNSON. Austin did go through the recession, so to speak, and came back out of it, and you participated in it, I take it.

Mr. KADISON. Fortunately, we didn't participate in too many bad ones, but we were lending during the bad times and used the SBA loan program as one of the vehicles to be able to do it.

I might just point out in answer to Mrs. Meyers' question earlier, one of the reasons we used the SBA Program, which ties very neatly into yours, we have limits placed on us by OTS in the amount of commercial lending a thrift is allowed to do, which is 10 percent. In order for us to leverage our involvement, by making loans and selling off the guaranteed part, we leverage that by factor—I mean our average guarantee is probably 81 percent.

So we get a four or five-to-one benefit. In the 5 years or so we have been in the SBA Program we have done somewhere between $17 and $18 million worth of loans, which would far exceed the limit that OTS places on us for commercial lending, which doesn't include the non-SBA guaranteed commercial loans.

Mr. JOHNSON. OK. You said that was part of your business plan, which it sounds like it was. If the guarantee were lowered, do you anticipate some reduction in that business, sir?

Mr. KADISON. Absolutely.

Mr. JOHNSON. You got any idea what it would do?

Mr. KADISON. Well, I haven't——

Chairman LAFALCE. Would the reduction be lower for a thrift than a commercial? Because the thrift is still going to want to maximize.

Mr. KADISON. Oh, we are going to want to maximize our involvement, no question. Now we are a preferred lender. We don't use the preferred lender program to near the extent that we are allowed to. Mostly because we were asked only to use the preferred lender program for higher quality credits, startups, restaurants, purchases, certain programs that just had a higher risk component.

Mr. JOHNSON. Who asked you to do that, Small Business?

[Mr. Johnson's statement may be found in the appendix.]

Mr. KADISON. The SBA in San Antonio. I certainly understand the rationale behind it. Certainly we honor that request. So we are not an active user of the preferred loan program.

I mean, we have done a half a dozen loans maybe in the little over a year we have been a preferred lender. But it has nothing——

Chairman LAFALCE. Approving a loan as a preferred lender gives you a lower guarantee.

Mr. KADISON. Interesting, that is not the reason.

Chairman LAFALCE. Really?

Mr. KADISON. I mean it is so much easier to just turn to the borrower and say, yes, done. The guarantee percentage is 20, $25,000

on our average loan size. Going from an 85 to an 80 on a 5 percent difference——

Chairman LaFalce. Not that big of a deal?

Mr. Kadison. No, not really, not for the speed.

Mr. Wilkinson. On an individual loan, it is not that big a deal, but when he starts talking about his portfolio limitations, he doesn't have the ability to just keep adding more and more dollars on a portfolio. I would not argue that an 85 to 90 percent difference is an issue. If that is the difference in approving a credit, I have got some problems with that.

Chairman LaFalce. Thank you.

Mr. Kadison. I appreciate it, Tony, thank you.

Chairman LaFalce. Go ahead, Sam.

Mr. Johnson. Did you have a comment?

Mr. Shivers. Well, I agree with what Tony said, Sam. To get to Mr. Flake's comments about the examiners, we have had problems with young, overzealous examiners: They say look, hell, this is an SBA loan, there has got to be something wrong with it. Want to classify, especially want to classify the unguaranteed portion of it. That is unsecured loan because SBA has got all the security so you need to put up reserves for that, I am going to put it doubtful or charge it off or whatever.

Then you have to argue with them when they tabulate all their numbers that they throw in the guaranteed portion also, that just kind of doubles up stuff.

Mr. Johnson. The Chairman has talked to that already, and I wonder, have you seen any change in the regulators?

Mr. Shivers. We have an examination in 30 days, I will know better after that. As most bankers, Mr. Chairman, we are going to wait until we see a marked change in attitude of the field examiners that we have to deal with.

Chairman LaFalce. I would be very interested, especially if they toss the guaranteed portion in. That is the troubled category.

Mr. Wilkinson. Can I add just two quick comments of examples what have happened in the last year?

Ms. Meyers, you have a bank in the State of Kansas, whose entire portfolio was classified substandard, and the board was criticized for getting involved in the SBA business. They had to liquidate their entire portfolio. It was sold to a nonbank lender, they took over, and the bank was left with a significant amount of cash and told not to get into the SBA business.

A second issue that we have been working on since 1990 is the accounting issue. I was under the impression that the Federal regulators were to be moving more toward generally accepted accounting principles. As we sit here today, this industry, the SBA lending industry, has some $200 million in earnings that have been taxed by the IRS, that are reportable under generally accepted accounting principles that the regulators have chosen to ignore. That is a lot of capital that we could put to work.

So while I agree that there is probably a new tone, it hasn't got down to our level yet and we still have some significant regulatory hurdles in front of us.

Mr. Johnson. Thank you, Mr. Chairman. I yield back.

Chairman LaFalce. Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman. Not to be surprised, I am going to go back to the previous point. We had the Acting Administrator—I can't remember her name, before the new administrator was appointed—that came in, or the Deputy Administrator testified before this committee and I brought that up. Some of the banks in my district that had complained that not only were they, like you had mentioned, being told to reserve for the unguaranteed section, but were also being told for the guaranteed section.

I remember the testimony, maybe staff can help me remember this, but I remember the testimony from the SBA, that, one, that they couldn't even make you reserve for the unguaranteed section. Is that correct? I think they said that.

Chairman LAFALCE. No.

Mr. BILBRAY. OK. I misunderstood what they said. But definitely could not do it for the guaranteed section. That it was a violation of the law to require you to do so.

They called me afterwards back in my office and I gave them the names of a couple banks that had complained to me in my district and they were investigating it. So I mean they actually made it clear that not only was it—there was no discretion, that it was a violation of either their rules or the law or something for the regulators to require you to do so.

So—and I was really thought that they had said that the unsecured section was under a special exemption, too, or something, but maybe I misread that. But, Mr. Chairman, the reason I am asking that, because from what I gather from Mr. Wilkinson, that this has become a pretty serious problem or is it just a minor problem?

Mr. WILKINSON. It is an ongoing issue. I wouldn't say that every field examining office has the same attitude about the SBA Program and it does seem to pop up from time to time. But it is still a problem. I have got some concerns with——

Chairman LAFALCE. Let's put them in perspective, Tony. Is it that large of a problem? It has been a problem. I don't know how large of a problem.

Mr. WILKINSON. Yes, I think it is a problem. I don't think that the communication channels down to the field are sufficient enough. I do think you have a lot of novice examiners out there who take the position that if you have to put a Government guarantee on that loan, it is inherently bad. I disagree with that position.

We still hear a lot of comments from folks that are having trouble. I go back to the bank in Kansas that had a wonderful portfolio, had no defaults, the entire portfolio was criticized, they are required to set aside reserves on the entire portfolio, and the board of directors ultimately made the decision to get out of the SBA business and sell off the portfolio. That is not right, that is just not right.

Chairman LAFALCE. That specific situation is absolutely wrong. The question is to what extent is this anecdotal? How prevalent is it? That is the point I am trying to reach.

Mr. SHIVERS. It varies from what group of examiners you get each time.

Mr. Chairman, I had an examiner one time show me how far-fetched some examiners can get. They questioned, the repayment

ability of a borrower, and I was secured two-to-one with a Treasury bond. I never worried about how I was going to get repaid.

That is about as ridiculous as you can get. But some of them do take the attitude, if it is a Government guaranteed loan, it has automatically something wrong with it, and they look harder at those sometimes. This is from an individual examiner's standpoint.

But we have heard many times from this city, we are going to have regulatory change. Comptroller Clark of the, OCC, a very close friend of mine, he said we are going to tell the examiners, quote, use some common sense. It never got outside the Beltway.

Mr. WILFONG. Congressman, my experience has been a little different. We are in the examining process right now. We are a $9 billion dollar bank. Our experience has been that as long as we risk-rate the unguaranteed portion appropriately, that the examiners are fine with the risk rating on the guaranteed portion. Our experience has been in that way different.

Mr. BILBRAY. So you haven't had a major problem as long as you document your papers.

Mr. WILFONG. As long as the unguaranteed portion is appropriately risk rated.

Chairman LAFALCE. Of course, we require risk-rated capital now for everything.

Mr. BILBRAY. Well, I think that hopefully—I think, to be honest with you, my personal opinion is that no matter what you say to these regulators, that the ones that are afraid they are going to get burnt down the line if something, but I think they are still afraid that if 5 years from now or 3 years from now there is a major crisis, and the bank they have been regulating goes under there is going to be somebody cut their head off for allowing it to happen. So I don't know how you get the word down unless you——

Chairman LAFALCE. Why don't you give me whatever examples you have, no matter how anecdotal they may be, of instances where an unguaranteed portion of SBA loan has triggered some adverse reaction by an examiner simply by virtue of the fact that the other portion of the loan has been guaranteed. Let me communicate that to the appropriate regulators, whether it is the Comptroller or the FDIC, OTS, Federal Reserve Board, whatever the case may be, to ask them to get the word down to the field, even better in the future than they have in the past. I think that this administration and its regulators will be very cooperative in that.

Mr. BILBRAY. Mr. Chairman, I look at it like the biblical story of Moses marching the Israelites in the desert for 40 years to get rid of a whole generation. I am afraid this is the same situation we are going to face here. We have these regulators that have been burnt, they have been involved, they have seen their friends demoted or in trouble because they let certain situations happen. It seems until you, it seems like, clean out the whole pack, I don't know how you are going to end up working this problem out.

Mr. FLAKE. Mr. Chairman, I resent him using theological analysis.

[Laughter.]

Chairman LAFALCE. Mr. Torkildsen.

Mr. TORKILDSEN. Thank you, Mr. Chairman. For the people who testified, thank you for your testimony.

Follow-up in an area that the Chairman mentioned on. For those of you who run your own institutions, do you sell any of the guaranteed portion of your SBA loan in the secondary market? If you do, do you have any rough percentages of how many of your guaranteed portion of your SBA loans do you sell in secondary market?

Mr. KADISON. We sell 100 percent of the guaranteed part.

Mr. TORKILDSEN. OK. So you are, you—once the loan is set up, you immediately go to the secondary market?

Chairman LAFALCE. He is a thrift, mind you.

Mr. KADISON. Yes, we are a thrift, and as a consequence we have limits on the amount of commercial lending we can do. To leverage that, we obviously sell it off immediately.

Mr. TORKILDSEN. OK.

Mr. SHIVERS. We are keeping all ours right now for the simple reason we don't have much loan demand and we need every loan we can get.

Mr. WILKINSON. You will see everything in the range. Today only about half the loans that are made are sold on the secondary market and it tends to run along a scale of smaller institutions with high loan demand are selling everything they can, all the way up to the larger institutions that are holding them in their portfolio.

Mr. TORKILDSEN. For those of you who are with national perspectives, have you looked at either facilitating that or encouraging resale more as a way of sort of opening up the avenues for loans? Has that been explored?

Mr. SHIVERS. I think that is on a bank-to-bank or lender-to-lender decision. They have to make the decision due to the overall loan demand in their sector. You have a high loan demand, you sell off a bunch where you have room to make more loans. I need all the loans I can get so I am going to keep them.

Mr. TORKILDSEN. Very good. Thank you.

Chairman LAFALCE. An interesting thought occurred to me. To what extent do you think that the tremendous increase in the desire for utilization of the SBA guaranteed loan is a function of, A, greater demand; B, a reluctance of the banking community to make loans without guarantees just because by making loans with the guarantees they can either improve their capital position tremendously, even if they hold the paper, or sell the paper off so that they don't have to hold capital against it and they can reuse the money; or C, because of an increased awareness on the part of thrifts, which historically were not involved in commercial lending, that they could become involved in commercial lending and greatly expand the percentage of their activity involved in the commercial field, circumventing, if you will, the limitations imposed upon them by selling off into the secondary market? Or all of the above.

Mr. WILFONG. Mr. Chairman, I can't speak for the thrift industry and I will let Mr. Kadison do that, but from the commercial banking perspective, the answer of Congresswoman Meyers' question, I pulled some rough numbers, we have about a $140 million in small business loans, of which $15 million are Government guaranteed loans. So we believe in the small business process.

We utilize the Government guarantees appropriately as it relates to the need for credit enhancement. We do not sell those loans to

the secondary market. I believe that the increased demand for the SBA has been because of an increased awareness by the banking community that the community needs, as it relates to small business lending, is something that needs to be addressed, and that one of the vehicles used in order to be able to lend into these communities where less than creditworthy businesses reside in a particular area has been enhanced with the small business process.

Chairman LaFalce. To what extent, Mr. Kadison, are the thrifts becoming more commercial loan oriented?

Mr. Kadison. In our area, I don't see it. There aren't very many.

Chairman LaFalce. So you think you are fairly unique?

Mr. Kadison. There are very few thrifts in our area. I can't speak to what transpires elsewhere. It is a logical extension of our business.

Mr. Wilkinson. In the NAGGL membership, we only have a handful of thrifts that are active.

Chairman LaFalce. I remember a decade ago I pulled together thrifts from my congressional district with the SBA and said, look, there is a dynamite capacity here.

Mr. Kadison. It is a wonderful program.

Chairman LaFalce. Use it, you could make a lot of money this way and still provide a very valuable service.

Mr. Kadison. Well, all these thrifts have gone out and done adjustable rate loans residentially, can wind up creating adjustable rate loans commercially and having great diversification because you only have very small amount of credit risk on each individual loan. I mean we also use the program because it allows us, as somebody else pointed out—I mean we did a $1.5 million loan which far exceeds SBA's guarantee. We were able to sell loan participation, we took 5,000, somebody else——

Chairman LaFalce. Let me get to a technical question. Let's suppose we have *x* dollar amount of money, $200 or $250 million, whatever the case might be. That is what we can come up with. Using the present formula of how much money we need to subsidize loan guarantees—well, $181 million is going to buy us about $3.3 billion of initial guarantees for this fiscal year.

Is there any way if we had $181 million we could say that the formula used by SBA and OMB to determine the appropriate subsidy rate for a loan guarantee is inaccurate and therefore using the same amount of money we might be able to argue that we could justify $5, $6, or $7 billion in guarantee authority?

Mr. Wilkinson?

Mr. Wilkinson. Let me start by saying I would not ask anybody to cook the books to make this look right.

Chairman LaFalce. Not at all.

Mr. Wilkinson. I do think there are some modifications that could be made in the formula. For instance, SBA is required to use a 10-year default rate that goes back before the quality lending initiative was started. So today current borrowers are being penalized or are not getting the full benefit of these initiatives that have taken place.

If we would use more of a 6- to 7-year horizon, you would see the default rate estimates fall substantially, which would in and of

itself cause the subsidy rate to recline. We change the default interest calculation, you see another drop in the subsidy rate.

I don't know exactly what the numbers that would create. I will get with the SBA and find out as they work it through the subsidy model what the number would be, but you have got to be talking 50 to a 100 basis points just making some clarifications in the model.

Chairman LAFALCE. Let me ask the representatives of this table and organizations to get their comments, to go back to the books and see if you can come up with an analysis of the formula that we are using right now and the economic assumptions that were built into that formula, and whether or not they are still valid.

If they are not valid, what new economic assumptions should be used for the formula, to come up with something that is honest and that, depending upon how the cookies crumble, may mean we buy less guarantee authority or may mean we buy more guarantee authority with the same dollar amount. Fair enough?

Yes, let's work together on that. Also let's temporarily recess, we have a vote. We thank the first panel. We will reconvene in 10 or 15 minutes to hear from panel number two. Thank you very much.

[Recess.]

Chairman LAFALCE. The Small Business Committee will reconvene.

We will hear from panel number 2, if panel number 2 could please take your seats.

We have a lot of old friends at the table. I should say long-standing friends instead of old.

JoAnn, you are now the star of the Wall Street Journal.

Why don't we just go right down the row starting with Mr. Carroll.

TESTIMONY OF FRANCIS R. CARROLL, PRESIDENT AND FOUNDER, SMALL BUSINESS SERVICE BUREAU, INC., AND CHAIRMAN, LEGISLATIVE COUNCIL

Mr. CARROLL. Good morning, Chairman LaFalce, and members of the committee. Thank you for the opportunity to speak to you today on the Small Business Administration's budget request for 1994.

My name is Francis R. Carroll. I am president and founder of the Small Business Service Bureau, and serve as Chairman of its Small Business Legislative Council.

SBSB is a national membership organization representing more than 35,000 small business firms. SBSB was founded and exists to provide legislative advocacy, management assistance and group benefits and services to small companies employing fewer than 50 people.

Most of our members in fact are self-employed, sole proprietors, partnerships, and unincorporated partnerships employing 10 or fewer people. We represent some of the Nation's true small businesses.

Personally, my credentials include over 11 years of service on the Small Business Administration's National Advisory Council, as appointee of and under Presidents Ford, Carter, and Reagan adminis-

trations, and I am also a founding member of the Democratic National Committee's Council on Small Business.

This service, and more than 30 years of working with small business people, has made me acutely aware of the problems they face, especially in regard to capitalization.

In 1953, then-President Eisenhower, as we know, created the Small Business Administration to promote, assist and counsel small firms and to make direct loans with Government money. Over the years, the agency has evolved and today, one of the most successful programs it administers is the 7(A) Loan Guarantee Program. Throughout the years, the SBA and its 7(A) Program has meant the difference between success and failure for thousands of small businesses.

Consider this; the SBA has delivered more than 12 million loans, contracts, counseling sessions and other forms of assistance to small businesses. With a direct and guaranteed business loan portfolio of approximately $22.5 billion, SBA is the largest single financial backer of small business today.

Under this program, small businesses are able to secure much needed capital from banks. Ninety percent of those loans under $155,000 are guaranteed by the Federal Government. Without those guarantees, many small businesses cannot borrow on affordable terms. In addition to the Government guarantees, the program provides favorable terms that are otherwise unavailable to small business. For example, the loans are commonly made at close to market rates and repayment periods are longer.

I think you can agree that the small business sector will be the force which brings the country out of its current economic slump. As we all know, the contributions of young small firms to the innovation and job creation is far more significant than that of big business. Small businesses provided all of the net new jobs from 1988 to 1990, were 99.7 percent of all employers in 1990, employed 65 percent of the private work force in 1990, created 40 percent of the Nation's new high technology jobs last year, and provided two of every three new workers with their first jobs.

The administration has proposed a reduction in the Government guarantee program from 90 to 70 percent, and the imposition of a surcharge on lenders if the loans are sold in secondary financial markets. Many private lenders say this would force them to make fewer SBA-backed loans. We can all argue the proposals contradict President Clinton's campaign promise to spur growth among small businesses.

I think the administration is making a big mistake, although with good intentions, proposing to limit access to capital for the small business community. Small business represents the only current positive economic trend. It is counterproductive to inhibit the one sector of the economy enjoying any real growth.

According to officials at Worcester County's Flagship Bank and Trust, a local bank, in the last 2 months the bank has approved, or is in the process of approving loans to 33 companies representing approximately $7 million in financing and leading to the creation or retention of almost 1,200 jobs in central Massachusetts. The average size of these loans is $130,000. The new ruling would put a number of those loans at risk.

When I interviewed Flagship officials, they indicated they were strongly opposed to the imposition of a surcharge for selling to the secondary markets. It discourages liquidity. The imposition of this fee will be devastating to the 7(A) Program. Coupled with the guarantee rate reduction, Flagship officials fear the administration's proposals will deter new lenders from participating in the 7(A) Program and discourage participants from approving any marginal loans. From my experience, I agree with them.

A Worcester-based small wholesale company with $6 million worth of property and a credit history that includes satisfying a $1 million loan in 7 years was recently denied a loan for $500,000. I have urged this company to try for an SBA loan, but now I wonder if they will meet the same fate, especially if this SBA change is made. Their survival is threatened under the administration's proposal.

Everyone talks about helping small businesses and taking steps necessary to help small business create the jobs this economy must have to move forward. This proposal moves in the opposite direction of that pledge. I would recommend adding more money to the 7(A) Program, not cutting it back.

The Federal Government has a responsibility to the small businessmen and women who built this country, to stand with them and grow and not to hurt them. In my opinion, the White House is mistaken when they say the proposed changes will help more than hamper lending. It is essential, now more than ever, the Federal Government stand by the small business community and retain the current guarantee rate of lending to small business.

I strongly recommend, Mr. Chairman, you maintain the current SBA guarantee rate for small business loans and oppose the imposition of a surcharge.

Thank you for the opportunity to present my views. I will be happy to answer any questions later if you should ask.

[Mr. Carroll's statement may be found in the appendix.]

Chairman LaFalce. Next is Mr. Lewis A. Shattuck, representing National Small Business United.

TESTIMONY OF LEWIS A. SHATTUCK, EXECUTIVE VICE PRESIDENT, BARRE GRANITE ASSOCIATION, ON BEHALF OF NATIONAL SMALL BUSINESS UNITED

Mr. Shattuck. Thank you very much, Mr. Chairman. Mr. Chairman and members of the committee, I am representing National Small Business United. I was secretary at NSBQ and am a trustee emeritus. I am currently also the executive vice president of the Barre, Vermont Granite Association. It is one of the major industries in Vermont that imports $100 to $200 million into the State. It is composed mainly of small businesses, Mr. Chairman.

Chairman LaFalce. If I might interrupt. We will put your entire prepared remarks in the record, but I am going to ask all of you to hold your remarks to no more than 5 minutes. I have an appointment at 12 o'clock.

Mr. Shattuck. We will do that, Mr. Chairman.

Chairman LaFalce. I will be fashionably late, but not too late.

Mr. SHATTUCK. I was with the Small Business Association of New England for 25 years and have been an SBA watcher for 30 years. I was on the National Advisory Council. I brought with me today an empty gallon can of gasoline. I brought it because when Mr. Bowles was here on the 19th, he spoke to the members of this committee and he said the engine that drives the economic train of this country is out of gas.

So, I am here to bring you a spare can and I hope the committee will see fit to fill it up. It is symbolic. It is only a one gallon can, but what we are asking the SBA for is help in the coming year that is a really modest amount of funding considering the enormous returns, Mr. Chairman, for every dollar spent by the agency or funded by the agency in guaranteeing these loans.

We talk of a ratio of 20 to 1, Mr. Chairman, on an agency that has taken enormous hits in budget cuts. But for the past 12 years, with leveraging of all resources it does in its many programs, there is no agency that returns more to the taxpayers of this country than appropriations to the SBA.

Mr. Chairman, the Price Waterhouse report that came out last year indicated the enormous tax benefits that were generated by the recipients of SBA loans.

It is legion in terms of the job generation that comes from SBA loans, Mr. Chairman. The fact is that this administration knows full well, the President has said that he is determined to help do whatever is necessary to help the SBA, and thus small business, generate jobs for the economy and get the country moving again.

Mr. Chairman, there is no better way. The cornerstone of any job generating program this administration can come up with is to fully fund the SBA, and it is not currently funded and the appropriation they are asking for will not do it.

I think to have the SBA Loan Program in a stop and start again situation, will do more to bring the agency into a posture of failure than David Stockman tried to do back in the days of President Reagan.

The fact is, if you have an agency that does not have programs that function smoothly and if you overpromise to the small business community in a loan program that stops and starts again, you are going to have a credibility problem. You are going to have services stopped, and you are going to have an unhappy small business lot of customers and they will not come back to the agency again. The banks, if they are not given opportunities and incentives to provide SBA loans, Mr. Chairman, won't.

Chairman LAFALCE. Absolutely.

Mr. SHATTUCK. Can I move to a couple other points?

Chairman LAFALCE. We will be doing a lot of talking with the administration between now and then.

Mr. SHATTUCK. Glad to hear that.

Other programs other than the loan program I think we ought to touch on, Mr. Chairman, because they are all very important programs. The SBIC Program started in 1958, it provides high risk startup for many high tech companies financing. It would do even better if Congress would lower the capital gains tax, but short of that, SBIC's should be funded fully because they do the job, and I think they are unsung heroes in terms of their participation.

SBDC's have more demand for their services than they have funding. They are in 50 States and are very, very popular as the best means for the SBA to provide management assistance. The Local Development Programs under 502, 503, or 504. Again that started in the 1960's. They do an outstanding job.

The Surety Bond Program saves millions of dollars a year, has a 98 percent success rate and allows those in the granite business to get involved in construction that they wouldn't otherwise be able to. I commend that program.

SBIR, the research programs, $1.1 million, to fund a program that has been outstandingly successful, Mr. Chairman.

The international trade programs of the SBA has only a few employees. Now, with the dollar as low as it is, export is the name of the game for small business. This program, I think, should be encouraged and expanded.

The Office of Advocacy was started in 1973, Mr. Chairman, because of the Washington Presentation by a lot of small business organizations. That are now part of NSBU. The new administrator wants the agency to be the champion of small business needs at the highest levels of Government. That is what the office of advocacy is for. We need an advocate in that position as soon as possible, Mr. Chairman, to head this very valuable research and advocacy arm of the agency.

Last, Mr. Chairman, 3 years ago, there was a hearing to establish a White House Conference on Small Business in 1994.

Nothing has been done since. It was a disgrace, in my opinion that President Bush sat on this legislation and didn't do anything to implement it. We need a White House conference soon as possible. A full-fledged White House conference, Mr. Chairman. We hope you can make that happen.

[Mr. Shattuck's statement may be found in the appendix.]

Chairman LAFALCE. I have just a few questions right now.

If any of you have any suggestions for a chief counsel for advocacy, rather than somebody who is the representative of this group or that group, but somebody who can be outstanding, we need an outstanding person, I would like to have you get that person's name and background in to me.

I intend to see that we don't have the long delay in this administration that we had in the previous administration, but I want it to be somebody who could really do an outstanding job, very forthright, aggressive, and very articulate.

As far as the White House Conference on Small Business, I think we are going to have to push the dates back. I just don't see how they can have it, have a successfully run operation now and have it during the time we legislated in 1990.

Mr. SHATTUCK. I agree.

Chairman LAFALCE. What should we push it back to? Right now the legislation says it has to be done by the spring of 1994.

Mr. SHATTUCK. By the first quarter of 1994, yes.

Chairman LAFALCE. First quarter of 1994.

Mr. SHATTUCK. Right. But it can't be done.

Chairman LAFALCE. Should we push it back to the last quarter? It gets involved in the elections if we do that. Push it over to 1995? Any recommendations?

Mr. SHATTUCK. I would say 1995, Mr. Chairman. You are going to have 60 State meetings throughout the country. You have to do it right. You are going to mobilize 50,000 to 60,000 people. You have to get the word out.

Chairman LAFALCE. The small business community would be supportable of 1995.

Ms. HOLLOWAY. I think they would, yes.

Mr. CARROLL. Yes.

Chairman LAFALCE. Anybody else?

Mr. PARSONS. Yes.

Chairman LAFALCE. Thank you very much, Mr. Shattuck. Our next witness will be Ms. JoAnn Price, president of the National Association of Investment Companies.

TESTIMONY OF JOANN H. PRICE, PRESIDENT, NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

Ms. PRICE. Good morning, Mr. Chairman. It is always a pleasure to come before you.

Today I want to speak briefly, of course, about the specialized Small Business Investment Company Program. I am the president of the National Association of Investment Companies, and we represent the Specialized Small Business Investment Companies, the venture firms that do primarily minority investing and those funds that are also staked or have something to do with State and local governments that also do minority focused investing.

Today we come before you with mixed feelings. We are pleased to have and hear about a new administrator that has a number of exciting things in store for the agency. We think it is a very positive step in the right direction. I would not be absolutely honest if I didn't say that we are excited about the budget proposal.

Having said that, I also understand that over the last 3 years, we have not adequately used the budget amounts that have been appropriated, and there have been a variety of reasons. We have been before you every year for the last 5 years citing those variety of reasons, so I won't go into that.

However, I want to make three or four points about the future of our particular side of the industry which I think are very real. I think it is very important to take this into consideration as we look at the commitment that our partner, the SBA, is willing to make into the future.

First, we had passage of a major piece of legislation to encourage the establishment of new investment companies and also obviously encouraging them to raise additional private capital.

Second, for the Specialized SBIC's, we have the preferred stock program which you were very instrumental in seeing happen over the last 3 years, and finally that is beginning to happen.

Chairman LAFALCE. I was one of the original authors of it.

Ms. PRICE. You were the author, Mr. Chairman.

Chairman LAFALCE. Along with Congressman Rangel.

Ms. PRICE. That was the tax initiative.

Third, we have the tax proposal that we have made some progress on through the House Ways and Means Committee, and hopefully, today on the House Floor which in fact, Mr. Chairman,

you were one of the major sponsors last year as we began this effort.

We are happy to say that we were able to really build momentum and have success through the House Ways and Means Committee, so it is——

Chairman LaFalce. Would you like to flesh out a little bit what the differences are between what I introduced last year and what is on the Floor today?

Ms. Price. The major—the bill that you introduced last year, we had an up-front tax deduction in that piece of legislation. We had the deferral legislation and that did go in in its entirety. We also had in—actually both of these provisions, I believe, were in the original legislation. The one that is not is the up-front tax deduction which we were not able to get into this particular legislation.

But as you know, Mr. Chairman, any time you are beginning to work on new concepts and new proposals, it takes a year or 2.

Chairman LaFalce. Can you give me a one-pager today with the identical provisions, the similar provisions, and the dissimilar provisions?

Ms. Price. I will be happy to do that. I will get that to you as soon as I get back to the office.

Today is timely because I have the opportunity to thank you and say that good work, good education, and a lot of support, we have had some success a long that line.

The fourth issue, which of course is the effort that we are involved in terms of raising the private funds to also direct capital into our marketplace. I made these—I have indicated these four major initiatives because all of these initiatives are designed to drive capital into our marketplace.

If all of these initiatives are ultimately successful, that means that the pressure on the Small Business Administration and the need to be able to come forward with funding as the years go along to deal with this issue, is going to be more substantial, so that I understand the budget restraints for the next fiscal year.

But I hope as we do this and as we bring more private capital into this marketplace, we keep in mind that we have to also have the rhetoric also match actual practice in what is happening at the agency.

So with that, Mr. Chairman, we are pleased to see a new direction with this new administrator. We are pleased to see this administration. We are pleased to see the support on capital initiatives. The only thing we would like to see in the future is greater support on the actual dollar sign. If we run out of money next fiscal year, we will use some of NASBIC's money.

Ms. Price. Thank you, Mr. Chairman. It is a pleasure to come before you. It is a pleasure to come before you. We thank you for your support and I will, when I get back to the office, get that information to you.

Thank you.

[Ms. Price's statement may be found in the appendix.]

Chairman LaFalce. My counsel tells me we have that information.

Representing your sister or brother organization, the National Association of Small Business Investment Companies but not specialized small business investment companies, Mr. Jim Parsons.

TESTIMONY OF JAMES A. PARSONS, CHAIRMAN, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. PARSONS. Thank you, Mr. Chairman, and members of the committee. I appreciate the opportunity to testify today on the administration's proposed 1994 fiscal year budget for the SBA.

Chairman LAFALCE. How many of your SBIC members are publicly held?

Mr. PARSONS. Mr. Chairman, there are probably two that I know of, not very many.

Chairman LAFALCE. Is that all?

Mr. PARSONS. That is all.

Chairman LAFALCE. One is in my district.

Mr. PARSONS. Allied here, and Capital in Southwest Texas.

Chairman LAFALCE. You have three? What are the three you have?

Ms. PRICE. We have two in New York, actually I think there is one in your district now—no, that is not publicly held. Two in New York.

Chairman LAFALCE. Do your recall the names offhand? I think you have six.

Mr. McNeish?

Mr. MCNEISH. Six.

Chairman LAFALCE. OK.

Mr. PARSONS. There used to be substantially more.

Chairman LAFALCE. Please continue.

Mr. PARSONS. I am testifying today in my capacity as Chairman of NASBIC, which is the trade association for the SBIC industry.

In my real life, I am a general partner of RFE Investment Partners, a venture capital firm located in New Canaan, Connecticut. RFE manages several venture funds, including an SBIC with $10 million of private capital which was licensed in 1980.

My testimony will focus exclusively on the SBIC Program, and our views of the funding needed in 1994 to revitalize this important, low cost, job creating program.

Mr. Chairman, the committee knows as well as we do that small growth firms are the primary engine of job creation in the U.S. economy. In normal business cycles, small business creates 65 percent of all the new jobs created in the economy. Recently, the job creation record of small business has been extraordinary. Between 1987 and 1992, small growth firms created 5.8 million new jobs, while big business lost over 2.3 million jobs. In short, small business created all of the net new jobs in the economy during the last 6 years.

What is less understood, however, is the severe problem small growth firms now face in obtaining the patient, long-term capital they need for growth and expansion.

Over the past 6 years, the sources of venture capital for small, emerging companies have literally dried up before our eyes. Here

is what has happened to the three major sources of venture capital for small business.

The level of institutional investments in venture funds has dropped sharply in recent years. In 1984, investments in venture foods totaled $3.2 billion. By 1991, that investment level had dropped to $1.3 billion. The net result is a sharp drop in the total amount of venture dollars available for investment in small growth firms.

The SBIC industry has suffered through a period of severe contraction. In 1985, there were 450 operating SBIC's. Today, there are only 200, and the rate of SBIC investments in small firms has suffered a proportionate reduction.

With the elimination of the capital gains tax differential, many so-called "angels" have withdrawn from venture investments in small firms, choosing instead to put their funds in more secure investment areas.

The net result is a severe shortage of long-term patient capital that new startup companies and small emerging businesses need to grow and survive.

The SBIC industry has a very successful track record in assisting small growth firms that create jobs and generate new tax revenues.

SBIC's have invested $9.1 billion in over 83,000 small business concerns since 1958, and these investments have created an outstanding record of cost-efficient job creation.

We have done several studies and they demonstrated that one job is created for every $17,000 of investment by SBIC and the Governments cost to create a job through the SBIC Program has been $875 per job.

We have recently completed an SBIC job creation study which we will be pleased to submit for the record.

Mr. PARSONS. Mr. Chairman, under your leadership and the leadership of this committee, Congress completely overhauled and improved the SBIC Program in late 1992. SBA is now finalizing the regulations to implement the new program. This newly restructured——

Chairman LAFALCE. What is your knowledge as to when we will be able to get the final regs?

Mr. PARSONS. The status of the regs, Mr. Chairman is they are drafted, they are awaiting Administrator Bowles review. He has promised to review them this week and make final decisions on a few of the provisions, and shortly thereafter, they will be sent over to OMB for their approval. We would estimate that that would happen probably by mid-June.

Chairman LAFALCE. There is no way we could really get under way until next fiscal year, October 1, is there?

Mr. PARSONS. Right. Mr. Chairman, our estimate is that with the whole approval process, the new regulations would really not be in effect until October sometime and, therefore, the $75 million appropriated for fiscal 1993 will not be used and we would support any efforts needed to reprogram those funds because we just won't use them.

Chairman LAFALCE. All right.

How are we handling the bankruptcy problem?

Mr. PARSONS. We have had several discussions with SBA. We are working directly with SBA to develop a compromise solution that would——

Chairman LAFALCE. It would require legislative action, wouldn't it?

Mr. PARSONS. Pardon?

Chairman LAFALCE. Wouldn't the compromise require legislative action?

Mr. PARSONS. It may. Our concern about the bankruptcy provision, if it is a total elimination of bankruptcies, it may make it a lot more difficult to raise capital with investors realizing that the SBIC's don't have access to bankruptcy protection.

What we are trying to do is to come up with a compromise that would still allow capital to flow into our industry but at the same time meet the concerns of SBA.

Chairman LAFALCE. Where did we put that proviso with respect to the effective date of the new program pending the bankruptcy changes? Was it in the appropriation bill, Tom?

Mr. POWERS. Yes.

Chairman LAFALCE. Was that prohibition valid for only 1993 or——

Mr. POWERS. It was a limitation solely applicable to fiscal year 1993.

Chairman LAFALCE. But is it a limitation that could be reimposed in the appropriations bill for fiscal year 1994? The earlier we work something out the better. I want to see this program operational October 1.

As soon as you feel you have something that is acceptable, bring it in to me and let's talk about it and see if Senator Bumpers is going to concur.

Mr. PARSONS. Yes. We will do that. We share your desire to get the program going and we know how important the bankruptcy provision is.

Chairman LAFALCE. Let's not leave it to the end.

Mr. PARSONS. No. It is actively being worked right now. We have had discussions over the past 2 weeks on that specific issue and we are making progress.

Chairman LAFALCE. Please continue.

Mr. PARSONS. As I was mentioning, Mr. Chairman, under your leadership and the leadership of this committee, Congress completely overhauled the SBIC Program, and the newly restructured SBIC Program can be a major vehicle to provide long-term patient capital. We right now have hundreds of experienced top quality venture groups poised to form knew SBIC's. We have private, institutional, and individual investors poised to invest hundreds of millions of dollars in the program.

Demand for the new program is phenomenal. Based on our contacts in the markets, we believe the program will generate the following level of activity in the next 5 years. We believe approximately 200 new SBIC's will be licensed.

We estimate that those SBIC's will raise a total private capital of $3 billion and will use Government guaranteed leverage of roughly $3 billion. This will result in total investments of $6 billion and will create 350,000 permanent new jobs.

However, the new program will only be successful if it attracts top quality venture managers and investment of a meaningful level of private capital. To achieve those two objectives, two things have to happen: One, the regulations have to be completed and they have to work; and two, investors have to have the confidence that the Government is committed to provide adequate funding.

As I have mentioned, we have been working with SBA to develop the regulations. We are optimistic they will be workable and that they will be ready shortly.

As we talked about the funding, we will not need it in 1993, but in 1994——

Chairman LaFalce. Do you think we have enough in the 1994 budget?

Mr. Parsons. That is what I want to get to. We have looked at what we think the demands will be in 1994. That will be a pivotal year because it is the first year of the program. We believe there will be between 75 and 100 license applications during the year with average private capital of $15 million. We think that roughly 30 new SBIC's will be licensed and will invest $150 million of their capital.

Chairman LaFalce. How much do they propose and how much do you think we will need?

Mr. Parsons. We need $150 million of the participating security and $100 million of the debentures.

Chairman LaFalce. $250 million, then?

Mr. Parsons. Exactly.

Chairman LaFalce. How much have they recommended?

Mr. Parsons. The recommendation currently is $167.7 million which SBA has reprogrammed, depending on the subsidy rates, $135 million for the participating security and roughly $80 million for the debenture.

We feel strongly that it needs to be the numbers I just mentioned for two reasons: One, it meets the demand; and two, it is an indication of significant support. We don't feel we need as much as was originally authorized in the legislation which was $250 million of participating securities and $180 million of the traditional debenture.

The primary reason we don't feel we need the whole thing is, with delays in the regulations being drafted, we are looking at funding flowing really in the last 6 months of the year. If the program starts in October, it will take time for people to apply, to get licensed, to take down capital and so on, so we are looking for the last 6 months to be the major time period for taking down the leverage.

Our proposal represents, depending on the subsidy rates, represents $10 million more than the administration's budget. The subsidy rates are moving around, so we are between $5 and $10 million more depending on the subsidy rate used for the participating new security. Most important is that appropriation that I just mentioned, we believe, will create 25,000 permanent jobs.

Mr. Chairman, the SBIC industry is highly sensitive to the need for the Federal Government budget to be reduced as a whole. This sensitivity, frankly, has caused us to recommend the absolute minimum dollars we believe necessary to attract the critically impor-

tant investment dollars to the SBIC Program which are, in turn, vested by SBIC's in rapidly growing job creating small companies.

Appropriating adequate dollars to the program in the first year of the revitalized program is critical in generating credibility of the program among investors.

Chairman LaFalce. You are only asking $4 to $5 million more than the administration requested.

Mr. Parsons. Depending on the subsidy rate, anywhere from $5 to $10 million more, yes.

Originally, the subsidy on the participating securities was 10 percent, we have recently learned that that may have increased it to 14 percent. We don't agree with it. We want to get into the details, but we have not been able to get copies of the most recent analysis.

Chairman LaFalce. Would you provide me with the information, too, because I want to make sure that this program gets off the ground right.

Mr. Parsons. We appreciate that support.

Chairman LaFalce. I have a vested interest in this, as I did in the other program, the 503 and 504 Programs, and I want to make sure the new participating security program gets off the ground.

Mr. Parsons. Appreciate your support, Mr. Chairman.

Chairman LaFalce. Let's go on.

[Mr. Parsons' statement may be found in the appendix.]

Chairman LaFalce. Ms. Janet Steele Holloway, President of the National Association of Small Business Development Centers.

TESTIMONY OF JANET STEELE HOLLOWAY, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS, AND STATE DIRECTOR, KENTUCKY SMALL BUSINESS DEVELOPMENT CENTER

Ms. Holloway. Thank you, Mr. Chairman. I appreciate the opportunity to present to you some of the impact and economic results of the National Small Business Development Center Program.

Currently, I am State director of the Kentucky Small Business Development Center Program. Before that, I was director of the New Jersey Program and serve currently as the national president of the Association of SBDC's. I will summarize my remarks and ask that the entire statement be entered into the record.

Chairman LaFalce. So ordered.

Ms. Holloway. I would like to begin by thanking you and your colleague, Neal Smith, for your continued support of the SBDC Program. Your leadership and support over the years has enabled nearly 3.5 million aspiring and established entrepreneurs to have access to the information, education, and advice about starting, growing and managing a successful business. This has contributed enormously to the economic stability of families and communities across this country.

Your recent support of the SBDC Program and willingness to communicate such to a new administration demonstrates the seriousness and dedication of yourself and Congressman Smith to the small business community.

On behalf of those working in the SBDC Program and millions of small businesses that have benefited, I would like to thank you for your support.

Since 1977, Mr. Chairman, SBDC's have provided free direct counseling to over 1,250,000 aspiring and established entrepreneurs in this country.

Chairman LAFALCE. Ms. Holloway, I think the SBDC Program has been an outstanding program and promises to be an outstanding program in the future with appropriate support. If you don't mind, I am going to ask you to come to the conclusion of your remarks. What is the bottom line?

Ms. HOLLOWAY. The bottom line is, I would like to talk about the demand for SBDC services if I may.

The demand for services continues to grow, as Mr. Shattuck has also pointed out. The downsizing of many corporations has resulted in a surge of demand for those wishing to start a second career in small business. Women entering the work force in record numbers are interested in starting small businesses and they represent about 30 to 40 percent of our client base today.

H.R. 820, which passed the House last week and supports technology development extension, will generate increased demands for business development assistance as new technology and processes are introduced in the manufacturing sector. I think it is very clear that just by introducing new technology or new processes alone will not make a business adequately different. They have to address the financing, marketing and structuring of that business and the changes that will be resulting.

Most people hear of the services from local referral sources such as banks and chambers of commerce and other local resources. SBDC's seldom advertise services. If we did, we would be overwhelmed with demand and we could not, we would raise expectations in a way that we could not meet those expectations.

I think, given the proven positive results of the SBDC Program, you would agree that most people and more people should have access to business development services that can help us create more jobs and build stronger economies.

As Mr. Carroll pointed out in his testimony——

Chairman LAFALCE. You have done a terrific job. You have just done a job for 40 women in my district who want to buy a plant. We have a 65-year-old individual who wants to sell and go south. They couldn't get a bank loan. They got the SBDC on it together, they put together a business package, shopped around for a bank, and were able to get it with the SBA guarantee.

They are waiting to close and that is for the Senate to act on the new money. We wouldn't act without SBDC. It is a classic case; no question about it. Happens all the time.

Ms. HOLLOWAY. Thank you, Mr. Chairman.

Chairman LAFALCE. What is your bottom line on the money?

Ms. HOLLOWAY. We would like to propose that the committee consider raising the authorization level of the SBDC Program to $150 million in the coming year.

Chairman LAFALCE. What is the current authorization?

Mr. POWERS. It is $67 million in appropriated money.

Ms. HOLLOWAY. We could certainly look at increasing that over time, sir, and I would like to see an additional $25 million in the coming year, that would be extremely helpful and enable us not only to respond to the businesses that are participating in the extension program, but——

Chairman LAFALCE. Do you have data with respect to women-owned businesses?

Ms. HOLLOWAY. Yes.

Chairman LAFALCE. Minority businesses?

Ms. HOLLOWAY. Yes.

Chairman LAFALCE. Technology?

Ms. HOLLOWAY. Yes, sir.

Chairman LAFALCE. International trade?

Ms. HOLLOWAY. Yes.

Chairman LAFALCE. OK, good.

Ms. HOLLOWAY. Manufacturers represent about 11 percent of our client base; women represent 30 to 40 percent; minorities represent about 23 percent of those using the SBDC services.

Chairman LAFALCE. Very good. Thank you very much.

[Ms. Holloway's statement may be found in the appendix.]

Chairman LAFALCE. Ladies and gentlemen, thank you very, very much for your testimony. It has been very, very helpful.

Mr. SHATTUCK. Thank you, Mr. Chairman.

Mr. PARSONS. Thank you, Mr. Chairman.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned.]

APPENDIX

OPENING STATEMENT OF
JOHN J. LaFALCE, CHAIRMAN
COMMITTEE ON SMALL BUSINESS

HEARING ON SBA's BUDGET PRIORITIES

MAY 19, 1993

Today the Committee is meeting to consider the Administration's programs and policies as embodied in the 1994 budget request for the Small Business Administration.

I am extremely pleased to welcome before the Committee the new Administrator of the Small Business Administration, the Honorable Erskine Bowles. We are pleased to have him appear before us exactly one week to the day of his having been sworn in as the 18th Administrator of the SBA.

Mr. Administrator, let me say at the outset that I look forward to working with you. With your business background as an investment banker, you will, I hope, lend a new perspective to the formulation and administration of policies in your agency.

For the past six years, the agency has been administered by political candidates who were defeated for other offices. They were good people, but basically had no experience in the business world and oftentimes could not fully respond to the needs of the small business community.

This is a critical time for small business. President Clinton has made it clear that his program to stimulate the economy and create new jobs will rely heavily on the growth potential inherent in the small business community. At long last we have an Administration which recognizes the catalytic effect that small business can have on our economy.

But if we are to rely so heavily on the potential of the small business community, we must meet its needs. If we fail to do so, it is not just small business, but our economy at large which will suffer.

The demands upon the SBA and its programs continue to grow. Your constituency is seeking additional financial assistance. Yet your major financial program, the 7(a) loan program guarantee program, has been closed and will remain closed pending enactment of a supplemental appropriation. Fortunately, in this regard, the House of Representatives is scheduled to take up just such a measure this week, H.R. 2118, which would provide $181 million in order to support additional loan guarantees this year of $3.3 billion, an amount which should see the program through the end of this fiscal year. The 7(a) program has been the sole safety valve for small businesses during the credit crunch and must continue to be available to play that role.

In addition to the 7(a) program, however, others in your constituency are also requesting more support in the procurement area, increases in management and technical assistance, development of minority small business and a myriad of other programs.

While the demand for SBA services continues to grow, there is another demand we must confront -- to reduce the federal deficit. Thus, I understand that it would be extremely difficult for the agency to receive an increase in either money or personnel beyond the current base. In fact, cuts may be in order. However, it is my highest hope -- and fairness demands -- that other programs and agencies be equally included in any such deficit reductions. The Small Business Administration cannot be expected to bear a disproportionate burden in balancing the Federal budget through reductions in its programs.

Furthermore, we must look at the bigger picture. Were deficit reduction our only goal, the response would be simple. But it is not. The Administration is also seeking to stimulate the economy -- spur investment, enhance community development, and create new jobs. We need more, not less, small business development and growth to achieve those objectives. Any draconian cuts in the small business programs that have been key sources of capital for credit-starved small business will fly in the face of the President's efforts to end the credit crunch.

We must strike an appropriate balance. If the SBA were to be eliminated, the savings would certainly make a significant contribution to deficit reduction. But we would aggravate, not solve, our economic problems. Everyone recognizes the importance of small business to our economy, to job creation, and to tax revenue. This understanding must be reflected in the size of appropriations requested for the Small Business Administration.

Mr. Administrator, we want to work with you to get our economy rolling. We believe that it can and should be done through small businesses and, with your guidance, through the SBA.

Do other Members have opening remarks?

STATEMENT OF REPRESENTATIVE JAN MEYERS
ADMINISTRATOR BOWLES PRESENTS SBA FY 94 BUDGET REQUEST
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
MAY 19, 1993

Mr. Chairman, thank you for asking our new Administrator, Erskine Bowles, to come before the Committee and testify on the SBA's FY 94 budget request. I think it's fair to say that Mr. Bowles has had a whirlwind one and one-half weeks on the job, having crossed paths with him a few times last week during the Small Business Week activities. Now, he's here to explain and defend his agency's budget request, as well as discuss any overall goals he has developed for the SBA. Frankly, I think he deserves our admiration for the way he has "hit the ground running" in his new position, and I look forward to working with him.

Mr. Chairman, I must say, having looked over the summary of the SBA's proposal and spent some time yesterday with Mr. Rosenbaum trying to decipher the SBA budget, that there has to be a better way to present this information. If Members don't understand the budget proposals, we certainly can't defend them--not to the Appropriations Committee, or to the Rotary Club back home. We need what I call a "kindergarten" explanation of this budget, and I would respectfully suggest to Administrator Bowles that this be one of his goals--to put the SBA budget in simple, easily understood terms. Once we clearly understand what has been spent in the past, and what is being requested for the future, we can have a meaningful discussion on the policy changes the Administration proposes for certain SBA programs.

Some of these proposals, most notably the decrease in the guarantee level for the 7(a) program, have been part of other Administrations' budget request for the SBA. Others may not be as familiar to Members. This hearing is the beginning of what I hope will be an extensive dialogue on SBA programs, their

function and funding levels.

While our Administrator has been on the job a grand total of about 8 days, I hope that today, or in the near future, this Committee can have an opportunity to discuss some long-term goals for the agency with Mr. Bowles. Many of us are very impressed with your background in small business finance and look forward to hearing your suggestions for making the SBA function more efficiently, providing maximum assistance to our nation's small business owners.

Administrator Bowles, thank you very much for being here today. I look forward to your testimony.

OPENING STATEMENT OF CONGRESSMAN BILL ZELIFF (R-NH)

Small Business Committee

May 19, 1993

Mr. Chairman thank you for calling today's hearing about the Small Business Administration's budget request. I would also like to congratulate Administrator Bowles for his recent appointment as head of the Small Business Administration.

As a businessman, Administrator Bowles is well aware of the importance of small businesses to our economy and recognizes the difficulties they often encounter.

My home state of New Hampshire is still suffering from the effects of a very difficult economic environment. New Hampshire and this nation are suffering from over regulation and the credit crunch which is jeopardizing our ability to create jobs. As the owner of three small businesses, I hope we can work together and find a cure for this critical problem.

I know that with Mr. Bowles background he will be able to provide strong leadership for the Small Business Administration and his experience will be a valuable asset to the small business community.

I look forward to today's testimony and hope he will discuss these important issues effecting our small businesses.

STATEMENT BY CONGRESSMAN JIM RAMSTAD
BEFORE THE HOUSE SMALL BUSINESS COMMITTEE
May 19, 1993

HEARING ON THE SBA'S BUDGET REQUEST WITH ADMINISTRATOR BOWLES

Mr. Chairman, I am pleased to welcome Erskine B. Bowles, the new Administrator of the Small Business Administration (SBA), to the House Small Business Committee today to discuss the SBA's budget request for fiscal year 1994.

While I have not met Mr. Bowles personally, his background certainly appears to give him a unique appreciation for the role of small businesses in our economy and the hands-on experience with small businesses and small business start-ups to provide the leadership we need at the SBA.

As a member of both the Small Business and Joint Economic Committees, I am keenly aware of the importance of small businesses to our economy -- and the numerous problems they have faced in recent years.

Whether it's the credit crunch, or burdensome government regulations, or onerous tax rates and a confusing tax code, our small businesses are increasingly burdened by the effects of wrong-headed government actions.

Small businesses, as we all know, are the real engine of job growth in our economy. In recent years, 85% of all new jobs in this country were created by small businesses, and in fact between 1988 and 1990, small businesses created <u>all</u> of the net new jobs in this country, according to the SBA's Office of Advocacy.

While I understand today's discussion primarily centers around the SBA's budget, I would like to take this opportunity to address several pressing concerns to small businesses with the new Administrator.

Unfortunately, all too many government policies stifle the entrepreneurial, job creating sector of our economy and dampen the ability of small businesses to do what they do best -- create jobs. We've all heard the chilling statistic -- there have already been some 27,000 pages of regulations published in the <u>Federal Register</u> already this year.

And most economists agree, President Clinton's proposal to transfer $328 billion from the productive, private sector to the federal government through the largest tax increase in history will certainly constrict economic growth and reduce the availability of capital. At a time of economic sluggishness, it is clear that enacting the largest tax increase in American history will have dire consequences for the jobs-producing, small business sector of our economy.

Administrator Bowles, as a former venture capitalist, must realize the harmful consequences of such a tax increase -- and the positive impact the capital gains tax reduction had in 1978 and the positive consequences it would have now in freeing up badly-needed capital for our small businesses.

While I understand he is constrained, I certainly hope he strongly considers the devastating consequences of harmful actions like these and serves as a forceful advocate for the genuine needs -- like reducing the regulatory and tax burden -- of the small businesses of our country.

Mr. Chairman, I look forward to reviewing the SBA's budget request with Administrator Bowles, and trust that his experience will give him the tools and experience to allow the SBA to provide assistance to the small businesses of this country in an efficient manner.

OPENING STATEMENT OF RONALD K. MACHTLEY
COMMITTEE ON SMALL BUSINESS
HEARING ON THE SMALL BUSINESS ADMINISTRATION'S BUDGET
MAY 19, 1993

Thank you, Mr. Chairman. And thank you, Administrator Bowles, for agreeing to come here today to testify on the Small Business Administration's budget.

The Clinton Administration has outlined numerous initiatives that are intended to help small businesses. Indeed, with 88 percent of all registered companies classified as small businesses, it is clear that we must focus on helping them stay competitive in an ever changing market.

Let me state first off that I am a strong supporter of numerous SBA initiatives that are designed to provide small businesses with management and technical assistance, and to assist these businesses in acquiring much-needed capital in order to expand operations or enhance research and development efforts.

Given the ongoing credit crunch throughout New England, and in many other parts of the country, it is important that small businesses have alternatives to traditional lending opportunities. I find this especially true in my state of Rhode Island which, according to the SBA publication "The State of Small Business: 1992," is ranked number 1 throughout the nation in small business failures. The SBA 7(a) program was specifically designed to encourage banks to lend to more "risky" businesses. This program has helped provide hundreds of Rhode Island entrepreneurs with the capital needed to start and stay in business. In 1993, the Rhode Island SBA office has already handled over 80 loans worth almost $19 million. So, as you can see, the SBA plays a major role in lending money to needy Rhode Island businesses.

Given Rhode Island's close relationship with the defense industry, government procurement provides many other businesses with their means for survival. This does not just include large companies. According to a report by the Rhode Island Defense Economic Adjustment Project, most defense-related companies in Rhode Island are small, having no more than 10 full-time employees and annual revenues of less than $5 million. I am, therefore, very interested in hearing any comments you might have on SBA initiatives to assist small businesses with government contracting.

I am also interested in hearing about SBA's proposed changes to it's Disaster Loan Program. In the past, Rhode Island has suffered from numerous natural disasters which have left many small businesses nearly crippled. The businesses in my state have found SBA's Economic Injury Loan Program extremely helpful in getting them back on track.

Most recently, the Federal Emergency Management Agency awarded roughly $1 million to the city of Pawtucket to help the city cover costs incurred due to the contamination of Pawtucket's aging water system which left residents and businesses without safe, drinkable water for over two months. The SBA was instrumental in assisting small businesses in filling out their applications for emergency loan assistance.

I am also impressed with Rhode Island's Small Business Development Center Program (RISBDC) which is operated out of Bryant College in Smithfield. This program, administered with SBA funds and supplemented with state and private contributions, provides low-cost training and one-on-one consulting on a variety of business topics. In addition, RISBDC provides procurement assistance to help companies sell goods and services to the federal government as well as assisting businesses in development of R&D proposals for submission under the Small Business Innovation Research Program. Most notably, RISBDC runs a highly successful Entrepreneurship Training Program which helps assist displaced workers in developing new businesses. With the eminent defense drawdown, RISBDC is also working closely with the Rhode Island Department of Economic Development and other parties to develop a smoother transition from a defense to civilian economy.

In the coming months, our committee will be presented with the task of passing legislation to keep the SBA in business. I look forward to hearing your the Administrator's testimony and discussing the proposed SBA budget for 1994.

Thank you, Mr. Bowles, for coming to our committee today to discuss the SBA's initiatives designed to help small business. I look forward to hearing your testimony.

Opening Statement of Congresswoman Eva Clayton

Committee on Small Business

May 19, 1993

I am very happy today to have the opportunity to hear the testimony of Mr. Erskine B. Bowles, a fellow North Carolinian, and the new Administrator of the Small Business Administration.

Small businesses are the backbone of this country. I believe that we will not see any improvement in the national economy until the small businesses in America are prospering again.

As a fellow North Carolinian, I know that Mr. Bowles must be, as I am, especially interested in rural development and in strengthening our rural economy. Small communities across my district and across the country have played a very large role in our nation's economic development and in defining our national character. Now these communities are threatened because of the lack of well-paying jobs and it is becoming increasingly harder for the citizens of small communities to find employment.

I am looking forward to discussing with Mr. Bowles his plans for minority small business programs. I would like to encourage him to ensure diversity in the various management and senior positions within the national and regional Small Business Administration offices.

I am committed to working to improve our rural economy and the status of small businesses. I look forward to discussing with Mr. Bowles how he proposes to keep small businesses, and small town America alive.

Hearing with Erskine B. Bowles, May 19
Congressman Walter R. Tucker, III

IT IS A PLEASURE FOR ME TO BE HERE TO LISTEN TO THE TESTIMONY OF MR. ERSKINE BOWLES, THE NEW ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION. TODAY THE SMALL BUSINESS COMMUNITY IS FINDING IT MORE AND MORE DIFFICULT TO GET THE CAPITAL IT NEEDS TO OPERATE AND EXPAND. MINORITY BUSINESSES SEEM TO FIND IT EVEN HARDER TO GET THE LOANS THEY NEED THROUGH THE SBA. I WILL BE LISTENING INTENTLY TO WHAT YOU HAVE TO TELL US REGARDING THE ADMINISTRATION'S PLANS FOR MAKING THE SBA A TRUE PARTNER OF SMALL BUSINESS. I THANK YOU AND MR. LAWRENCE ROSENBAUM FOR COMING HERE TODAY AND THANK YOU MR. CHAIRMAN.

Opening Statement of Congressman Cleo Fields before the Committee on Small Business May 19, 1993

Good morning, Mr. Chairman, today I am very happy to have before us the newly appointed Administrator of the Small Business Administration, Mr. Erskine Bowles.

As we all very well know, the small business sector is the backbone of our ailing economy. The President has made very clear that the small business community must play a vital role if we are to solve our economic problems.

I am very anxious to hear Mr. Bowles outlook for the future of the SBA as well as his plans to sustain and enhance existing programs within the Small business Administration. We all

know the problems facing the 7(a) program which hopefully will be rectified today when the house takes up the supplemental appropriations bill.

Furthermore, I am very concerned about your outlook on enhancing existing minority outreach programs that will give small and disadvantaged businesses an opportunity to grow, specifically, the 8(a) program.

Mr. Bowles, once again I am very happy to have you testify before this committee and I look forward to hearing your testimony. In the interest of time this will conclude my opening statement.

STATEMENT FOR
CONGRESSMAN FLOYD H. FLAKE
BEFORE THE COMMITTEE ON SMALL BUSINESS
BUDGET REQUEST
MAY 19, 1993

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE SMALL BUSINESS COMMITTEE. I WELCOME OUR WITNESS, THE ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, MR. BOWLES AND THANK HIM FOR THE TESTIMONY HE WILL PROVIDE.

AS WE CONTINUE OUR DISCUSSIONS ABOUT THE IMPORTANCE OF THE SMALL BUSINESS SECTOR IN CREATING JOBS AND SPURRING GROWTH, WE MUST BE PREPARED TO REFLECT THAT THROUGH THE SBA BUDGET. MOREOVER, PROGRAMS MUST BE IMPLEMENTED EFFICIENTLY SO THAT ALL FUNDS ARE UTILIZED IN THE MOST APPROPRIATE AND EFFECTIVE WAY POSSIBLE. IN SO DOING, IT WOULD BE INAPPROPRIATE TO UNNECESSARILY HARM EXISTING PROGRAMS THAT HAVE PROVEN SUCCESSFUL.

IT IS CLEAR THAT WE MUST MAKE AN EARNEST EFFORT TO REDUCE THE DEFICIT, HOWEVER, WE MUST ALSO ENSURE THAT ECONOMY STIMULATING PROGRAMS ARE NOT UNDULY HARMED. THIS ISSUE IS CRUCIAL FOR THE AMERICAN ECONOMY, OUR DISPLACED WORKERS AND FAMILIES THROUGHOUT THE UNITED STATES. WITH THAT IN MIND, I AWAIT THE TESTIMONY OF MR. BOWLES' SO THAT HE CAN ILLUMINATE THE PRIORITIES OF THE SMALL BUSINESS ADMINISTRATION AND HOW THE SBA REACHED ITS CONCLUSIONS AS TO THE MOST APPROPRIATE PATH FOR THE SMALL BUSINESS COMMUNITY.

AGAIN, I WELCOME OUR WITNESS, MR. ERSKINE B. BOWLES, AND THANK HIM FOR THE TESTIMONY HE WILL PROVIDE.

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STATEMENT OF CONGRESSMAN SAM JOHNSON

COMMITTEE ON SMALL BUSINESS

MAY 19, 1993

THANK YOU MR. CHAIRMAN, AND THANK YOU, MR. BOWLES, FOR YOUR PARTICIPATION IN THIS HEARING TODAY.

AS WE ADDRESS REAUTHORIZING THE SMALL BUSINESS ADMINISTRATION, WE MUST CONCENTRATE ON GETTING THE MOST BANG FOR THE BUCK. THIS MEANS STREAMLINING ADMINISTRATIVE COSTS, WITHOUT JEOPARDIZING THE QUALITY OF LOAN SERVICES TO AMERICAN SMALL BUSINESSES.

I'VE LOOKED OVER THE SBA'S FY 1994 BUDGET BRIEFING, AND I RECOGNIZE SOME OF THIS. THE PROPOSAL SUGGESTS A 4% REDUCTION IN FULL TIME EMPLOYEES OVER THE NEXT THREE YEARS AND A 14% REDUCTION IN ADMINISTRATIVE EXPENSES OVER THE NEXT FIVE YEARS. I THINK WE'RE ON THE RIGHT TRACK HERE.

I DO HAVE SOME CONCERNS, HOWEVER, OVER THE FUNDING LEVELS FOR SOME OF THE SBA'S PROGRAMS. FIRST, I QUESTION THE NEED TO SPEND $16 MILLION DOLLARS ON A TREE PLANTING INITIATIVE. ALTHOUGH I RECOGNIZE THE GOODWILL THAT THIS PROGRAM FOSTERS, I'M NOT CONVINCED THAT IT SHOULD BE THE SBA'S RESPONSIBILITY.

SECOND, I'M CONCERNED THAT THE SBA HAS REQUESTED $2.5 MILLION DOLLARS FOR A WHITE HOUSE CONFERENCE. TODAY, IN MY DISTRICT, THEY'RE TELLING SMALL BUSINESSES THAT THEY'RE BROKE AND CAN'T FINANCE THEIR LOANS.

I HOPE THAT THIS COMMITTEE CAN PUT PARTISAN POLITICS ASIDE AND REALLY WORK TOGETHER ON THE SBA'S BUDGET AUTHORITY. KEEPING OUR CURRENT ECONOMIC SITUATION IN MIND, I CHALLENGE THIS COMMITTEE TO PRIORITIZE THE SBA'S REQUESTS TO ENABLE US TO BALANCE THE BUDGET, WHICH WE ALL KNOW IS BEST FOR AMERICAN SMALL BUSINESSES.

OPENING REMARKS BY CONGRESSMAN JOE KNOLLENBERG MAY 19, 1993

Thank you Mr. Chairman, I would also like to thank Mr. Bowles for testifying before this committee this morning.

I must admit that I am a bit skeptical about the present mission of SBA. Many of the small businessmen and women in my district who are not receiving some kind of SBA financial support, have used the word "irrelevant" to describe what the agency means to them.

I understand that many support maintaining SBA in its current form, but I am looking forward to hearing Mr. Bowles thoughts about how we can reform the SBA to get more bang for the taxpayers' dollar.

Again, I thank the Chairman and look forward to hearing the testimony.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Statement of

Erskine B. Bowles

Administrator

U.S. Small Business Administration

Before the

Committee on Small Business

United States House of Representatives

May 19, 1993

Mr. Chairman and Members of this Committee, I appreciate the opportunity to appear before you today. Accompanying me is Lawrence Rosenbaum, my Comptroller. I am very excited to be serving as the new Administrator of the Small Business Administration. This job gives me that unique opportunity to both serve my country and, at the same time, utilize those business skills I have worked so long and hard to develop over the past 24 years.

Before I begin my testimony on budget considerations, perhaps it would be useful to lay out my vision for the Agency...my plans for the budget I'm seeking.

Briefly, my vision for the SBA reflects President Clinton's vision for small business. This President fully understands the absolutely critical role that small business plays in our economy. Let there be no question in your mind that President Clinton is determined to do what is necessary to help small business create the jobs this economy must have to move forward again.

President Clinton has set four priorities for me at the Small Business Administration:

First, we must do our part to end the credit crunch. We must find ways to free up capital for investment in small businesses. Small businesses are starved for capital.

President Clinton has already taken a giant step forward in this regard by removing the unnecessary and costly restrictions on banks that prevented them from making character loans. But we must do more. Small businesses cannot grow and cannot create jobs without capital. It's as simple as that. And, with your help, we're going to do something about it.

Second, we must get rid of the unnecessary paperwork and bureaucratic regulations that inhibit the growth and productivity of small business. Government regulations have a disproportionately adverse effect on small companies. The President wants me to attack this issue head-on, and I am absolutely committed to doing that.

Third, we must restructure, reorganize and reinvigorate the SBA so that it operates in a more efficient, effective manner, and truly serves our customers--the men and women who own and operate small businesses throughout this country.

Finally, the President wants the SBA to be his eyes and ears in the small business community. I promise you the SBA will be just that. We will serve as the President's listening post, hearing the concerns and ideas of small business. In turn, I will report these concerns <u>directly</u> to the President, thereby

ensuring that small business has a place at the economic table in the Clinton Administration.

My vision for the SBA reflects my business background. It reflects a leaner, more efficient, more effective organization that is focused...focused on meeting the needs of small business. My vision also reflects an organization that champions the needs of small business at the highest levels of government, guaranteeing small business a place at the economic table.

I am very pleased that I will have a chance to work with and learn from the Members of the Committee and your staffs. I want you to know that I realize full well that I have a great deal to learn. I believe that only by listening can I learn. Therefore, I look forward to taking every opportunity to meet with you and your staffs to hear your ideas on how we can do our job better at the SBA. I am particularly excited that my arrival at the SBA coincides with budgetary planning for the coming fiscal year. It will allow us to work together to promote the health and progress of the small business community.

Now to the business at hand.

FY 1993 FUNDING

Before I address our FY 1994 submission, I would like to review the shortfall in our FY 1993 General Business Guarantee Loan Program. The General Business guarantee funds were exhausted on April 27, 1993. Our General Business Guarantee loan program is completely out of funds. Members of the Committee,

the engine that drives the economic train of this great country is out of gas.

As part of President Clinton's Economic Stimulus Package, we requested an additional $141 million in loan subsidy authority to support an increase of $2.6 billion in guarantee loan levels. As you know, the bill was not enacted. However, we have not stopped working. We have continued to take loan applications and now have a backlog of unfunded loans of approximately $375 to $400 million. We plan to continue accepting loan applications for approximately one month so that if an appropriation becomes available, we can immediately begin to fund this demand for credit in the small business community. The Administration currently supports the House Appropriation Committee's supplemental appropriations bill for $181 million in loan subsidy authority to support a General Business Guarantee lending program totalling $3.3 billion.

Now I would like to discuss more specifically the Administration's proposed 1994 Budget for SBA.

FY 1994 BUDGET

The Small Business Administration's budget request focuses on two significant issues that confront the small business community: access to capital, and business development through procurement, counseling and training.

CREDIT PROGRAMS BUDGET REQUEST

GENERAL BUSINESS GUARANTEE LOAN PROGRAM

For FY 1994, the proposed policy initiatives will provide the funding necessary to both meet anticipated demand and reduce subsidy costs in our General Business Loan Program. In order to do our part to help reduce the massive federal deficit, we have included two significant savings initiatives for fiscal years 1994 through 1998. The first savings initiative would reduce the federal guarantee on loans from an average of 81 percent to an average of 75 percent. This means that lenders participating in the General Business Guarantee loan program will be required to assume a greater share of the risk in making loans to small businesses. Requiring lenders to assume a greater share of the risk will increase their scrutiny of potential borrowers, thereby reducing the default rate and increasing the recovery rate on repurchased loans. This initiative will save the taxpayers about $102 million in 1994.

The second savings initiative involves the secondary market. Approximately half of all General Business Guarantee loans are sold in the secondary market. We are proposing an ongoing fee of one-half percent per year on the unpaid guaranteed principal balance on all secondary market sales. These funds will be collected through our fiscal and transfer agents. This initiative will save the taxpayers about $67 million in 1994.

For the General Business loan program, SBA will request $154.8 million in loan subsidy authority to support a total of

$6.6 billion in guarantee authority to ensure that credit worthy small businesses that have previously been denied credit by their banks shall have access to capital.

In FY 1994, SBA will make approximately 26,000 general business loans to small companies, which currently employ an estimated 416,000 workers. Adjusting for business failures, it is estimated that approximately 318,000 jobs will be maintained by the use of these funds in our General Business Guarantee loan program. In addition, employment is predicted to grow by 101 percent between 1994 and 1998 if these initiatives are enacted, equaling approximately 321,000 new jobs. Therefore, the $6.6 billion in general business financial assistance provided to small businesses in FY 1994 will create and maintain more than 600,000 jobs during the next four years.

The General Business program provides almost 90 percent of our total business lending. Our two savings initiatives for the General Business Guarantee loan program combined will save the taxpayers approximately $169 million in FY 1994 and $724 million in subsidy budget authority over the next four years.

DEVELOPMENT COMPANY PROGRAM

Mr. Chairman, I'd next like to take a look at our request for $6.2 million in loan subsidy authority to support our $907.7 million request for the Development Company Lending Program (Section 502/504 Program). The amount requested is based on expected demand in FY 1994.

Since inception, more than 600 development companies have

been certified and 390 are active. Almost 16,000 loans have been approved for more than $3.8 billion. In addition to SBA assistance under this program, more than $6.5 billion in private sector investment has been made available and an estimated 327,000 jobs have been created or maintained. This program has been particularly helpful in creating jobs and employment opportunities in our rural communities. It is also a program where we get significant bang for our buck, since SBA only guarantees 40 percent of the capital going into a project.

SMALL BUSINESS INVESTMENT COMPANIES

As you all know, sufficient venture capital must be made available to small businesses. Companies requiring high-risk debt capital are generally excluded from mainstream capital markets. Yet these companies are critical to the future employment base of this country. For this reason, the Congress and the SBA have devoted substantial effort toward restructuring the Agency's SBIC loan program. In this budget we are requesting $25.8 million in loan subsidy authority to support a program authority of $167.7 million. We also plan a reprogramming of regular Small Business Investment Company funding to support up to $135 million within the requested loan subsidy authority of $25.8 million for our new participating security guarantee program. This will offer small start-up businesses the kind of patient capital they need to grow and expand.

In addition, we are also requesting to retain separate

funding of $5.2 million in loan subsidy authority to support a program amount of $17.9 million for a specialized, or MESBIC, guarantee program.

DISASTER LENDING

As you are aware Mr. Chairman, the SBA disaster program has provided a valuable service through the years and we're proud of this program. However, the realities of the budget situation require all of us to make certain judgments. In this regard, I'd like to discuss changes we propose for the Disaster Loan Program, which provides direct loans not only to small businesses, but also to homeowners and other businesses that have suffered financial or property loss in a disaster.

We propose to reduce the Disaster Loan Program's deep subsidy by increasing the interest rate on these loans from 4 percent to the treasury rate plus one percent. If this initiative is adopted, we estimate that it will cost us only $49.9 million in loan subsidy authority to support a $390 million disaster loan program. We estimate this change in interest rates will save $58 million on a program level of $390 million. During the next four years, we estimate that we would save over $245 million.

SUMMARY

In summary, the total budget authority request for Business and Disaster credit programs is for credit subsidies of $263 million to support programs totalling almost $8.2 billion for the small business community.

($ in Millions)

	1993 Availability		FY 1994 Request		Difference	
	Loan Sub. Authority	Program Level	Loan Sub. Authority	Program Level	Loan Sub. Authority	Program Level
Direct Loans	$ 25.8	$ 125.4	$ 21.0	$ 82.7	$(4.8)	$(42.7)
Guaranty Loans						
General Business Guaranty	197.9	3,618.0	154.8	6,589.0	(43.1)	2,971.0
Proposed Supplemental	181.0	3,309.0	-	-	(181.0)	(3,309.0)
502 & 504 Development Co.	6.0	739.6	6.2	907.7	0.2	168.1
SBIC	25.1	163.2	25.8	167.7	0.7	4.5
MESBIC	5.0	17.4	5.2	17.9	0.2	0.5
Total Guarantee Loans	$ 415.0	$ 7,847.2	$ 192.0	$ 7,682.3	$(223.0)	$(164.9)
Total Direct & Guaranty Loans	$ 440.8	$ 7,972.6	$ 213.0	$ 7,765.0	$(227.8)	$(207.6)
Disaster Loans	445.4	2,164.4	49.9	390.3	(395.5)	(1,774.1)
Total Loans	$ 886.2	$10,137.0	$ 262.9	$ 8,155.3	$(623.3)	$(1,981.7)

SURETY BOND PROGRAM

We turn next to our proposal for the Surety program. This program assists small contracting firms in obtaining bid, payment, or performance surety bonds. SBA assists by providing guarantees of up to 90 percent for the losses sustained by the sureties. This program boasts a 98 percent success rate that has resulted in a net government savings estimated in excess of $1.6

billion after offsetting program losses since 1971. In FY 1992, Surety Bond Guarantees helped to create 47,000 jobs, and more than $1 billion in contracts were infused into the small business community. We are requesting $13.4 million in budget authority in FY 1994 to support a program level of almost $1.9 billion. This compares to our FY 1993 availability of $13 million for a $1.8 billion program level.

NON-CREDIT PROGRAMS BUDGET REQUEST

PROCUREMENT ASSISTANCE

The small business community is an active participant in federal contracting. The SBA's Office of Procurement Assistance assists small businesses in this area, making sure that small companies receive their share of government procurement and sales. For example, in FY 1992, through our Natural Resource Sales Assistance Program, small business was awarded more than 1,800 individual federal timber sales, which represent more than 60 percent of the total federal timber sold. This program assures that the small business community will receive its traditional fair share of federal timber through small business set-asides.

We assist small businesses in federal contracting through the on-site location of procurement center representatives at major government procurement installations and through the continuous monitoring of government procurement and sales activities.

The Office of Procurement Assistance also manages the Procurement Automated Sources System (PASS), which contains data on approximately 250,000 small firms. This information is used by procurement officials and large prime contractors to locate qualified small businesses. The office also issues Certificates of Competency (COC), which document a firm's ability to perform certain functions under government contracts.

We estimate a savings of more than $295 million in FY 1994 from the increased competition provided by the Breakout and COC programs. These programs are expected to save the federal government $250 million and $45 million, respectively. From an expected procurement expenditure of $160 billion in FY 1994, we will establish a goal at a minimum of $32 billion in prime contracts for small business. The Prime Contracts program will achieve this by monitoring and managing the traditional procurement center representatives and breakout programs. An estimated total of at least $10.7 billion will be set aside for competition by small businesses, only, in FY 1994. In addition to prime contracting opportunities, SBA also assists small businesses with subcontracting opportunities. Through the efforts of our Commercial Market Representatives working with the major prime contractors, it is estimated that small businesses will receive subcontracting awards in excess of $20 billion in FY 1994.

MINORITY SMALL BUSINESS & CAPITAL OWNERSHIP DEVELOPMENT

As you know, the SBA has a long and successful history of promoting opportunities for minority business owners, and with the implementation of Public Law 100-656, SBA has renewed its commitment to the minority and disadvantaged small business community. This commitment reaches beyond the traditional programs operated by the Office of Minority Small Business and Capital Ownership Development (MSB/COD) to our financial, investment and special programs. We want to ensure that minority and disadvantaged firms are always considered in the administration of our basic programs. We are committed to minority economic empowerment.

In FY 1992, SBA approved almost 3,700 loans valued at more than $820 million to minorities. Additionally, our education and training programs counseled more than 74,000 minority entrepreneurs and trained almost 81,000 minority attendees. Consultants in the 7(J) Program counseled approximately 2,800 firms, and we are requesting $8.1 million in FY 1994 to continue this program. The 8(A) Program awarded 4,690 contracts worth over $4.3 billion in fiscal year 1992.

BUSINESS DEVELOPMENT

We also have a wide array of Business Development programs that promote the establishment, growth, and vitality of small businesses through technical support, effective training and counseling programs, and efficient allocation of resources.

Briefly, Mr. Chairman, let me run through a description of these initiatives.

Our Office of Women's Business Ownership provides support, counseling, and services to women-owned small businesses. This sector represents 32 percent of all small businesses and historically has been under represented in federal programs and activities. Women-owned businesses now employ more people than the entire Fortune 500. Women-owned businesses are expected to account for 40 percent of all small businesses by the end of this decade. When we expand SBA outreach to these businesses, we increase their economic impact. Our FY 1994 request includes $481,000 to support the Women's Business Council and $1.5 million to continue implementation of the Women's Demonstration Project Program. One of our goals during 1994 is to find ways to be more helpful to women-owned businesses. For FY 1994, we are also requesting $792,000 to provide for salary and related expenses to support the program.

We are also promoting international trade opportunities for small business through outreach, counseling, and training. The Office of International Trade (OIT), in conjunction with field offices, other program offices, and public and private trade groups, will continue to develop and implement trade activities targeting specific industries and markets. Expenditures for this outreach program are forecast at $481,000 for FY 1994. Additionally, we are requesting $1.4 million in salary and related expenses to support the program. OIT supports increased

use of the export revolving line of credit for the international trade loan program. As part of the General Business Guarantee program, we estimate that loans for international trade businesses will amount to $320 million in FY 1994 as compared to $290 million in FY 1993.

The Office of Business Initiatives, Education and Training (BIET) administers SBA'S Service Corps of Retired Executives (SCORE), which has provided free counseling and low-cost training programs to hundreds of thousands of entrepreneurs. More than 13,000 volunteers serve at 378 chapters and 500 branches across the country. We are requesting $3.1 million for this program in FY 1994 which is the same level available in FY 1993.

Another program administered by BIET is our Small Business Institute (SBI) program, which operates on more than 500 college campuses. Through the SBIs, students supervised by instructors provide management consulting to small businesses. We are requesting $2.9 million for this program in FY 1994 compared to $3.0 million in FY 1993. In addition to the program outreach efforts for BIET, we are requesting $18.1 million in salary and related expenses for FY 1994.

SMALL BUSINESS DEVELOPMENT CENTERS (SBDC)

We also have the Small Business Development Center (SBDC) program, designed to assist small businesses by linking federal, state and local governments with the private sector to provide management and technical assistance to the small business

community. Today, the SBDC program has a network of 57 lead centers located in 50 states and approximately 750 sub-centers and satellite locations. We are requesting $67 million for this program in FY 1994 which is the same level appropriated in FY 1993. In addition to the SBDC grants, we are requesting $1.0 million in salary and related expenses to support the program for FY 1994.

SMALL BUSINESS INNOVATION AND RESEARCH (SBIR)

During FY 1994, there will be a continued strong emphasis on assuring a high rate of commercialization of SBIR innovations. This important goal reflects a key provision of P.L. 102-564 and activities will be guided by the findings of the multi-year commercialization study and program experience and the emphasis of dual use innovations.

The overall direction of maintaining a strong public awareness effort will be continued to assure effectiveness at reaching potentially eligible small firms, particularly those owned and managed by persons from under represented groups or geographical areas. The FY 1994 budget is predicted on phased patterns of legislated growth. To support the SBIR effort for FY 1994, we are requesting $1.1 million for salary and related costs which is approximately the same level available for FY 1993.

ADVOCACY

The Small Business Administration is the only source of detailed information on small business contributions to the economy. Data on small business is gathered through a small business data base and through a contract research program targeted to examining contributions and barriers facing small businesses. This information is vital to policy development and is used in many ways to obtain and present a clear picture of the small business community. The data provides the foundation for the Advocacy Office's efforts to represent small business views throughout the government and Congress and to reduce regulatory burdens.

SBA's Office of Advocacy is responsible for gathering data on small businesses and maintaining the small business data base. The development and maintenance of this system has been the Office's major economic research project and imposes no paperwork burden to the business community. Instead, Advocacy utilizes private sources and interagency agreements with federal statistical agencies, such as the Internal Revenue Service, the Bureau of Labor Statistics, and the Bureau of the Census. The amount requested for Advocacy, to support the program, is requested at $5.2 million for FY 1994, which is approximately the same amount provided in FY 1993.

In addition, SBA is requesting $2.5 million in FY 1994 for the White House Conference on Small Business which is the same level provided in FY 1993. The conference will increase public

awareness of the essential economic contributions of small business, identify small business needs, examine the status of minorities and women as small business owners, and assist small business in carrying out its role as the nation's job creator. The conference will assemble small businesses to develop such specific and comprehensive recommendations for executive and legislative action as may be appropriate for maintaining and encouraging the economic viability of small business and, thereby, the nation.

UNAUTHORIZED PROJECTS

Finally, our request for non-credit programs excludes funding of all unauthorized projects that were earmarked in last year's appropriation act. We estimate that this would save $20 million in FY 1994 and $107 million over the next five years.

MANAGEMENT INITIATIVES

Mr. Chairman, during the past two years our loan activity has grown dramatically. In FY 1992, our General Business Guarantee program grew 37 percent, a pace that has continued for the first half of FY 1993. The subsequent increase in the SBA's portfolio value means we have an even greater need for oversight to assure that the assets of the Agency are well managed. This is consistent with my clearly stated goal of running an efficient, effective, well managed Agency.

We have also forecasted a reduction in employment in each

department of the Agency reducing total full-time equivalents by 59 positions, excluding Disaster Assistance and the Inspector General office, which are forecasted to be reduced by 818 and two full-time equivalents, respectively. Operating costs of the Small Business Administration are also forecast to be reduced in FY 1994 by a total of $2.6 million. Non-Credit Program costs, as well as Disaster Assistance costs, are now forecast be reduced substantially, while the cost for the Inspector General is expected to increase by $1.2 million.

	$ in Millions			Full-Time Equivalents		
	1993	1994	Diff.	1993	1994	Diff.
Finance, Investment, & Proc.	$100.6	$ 98.2	$(2.4)	1,848.9	1,821.2	(27.7)
Business Development	22.8	22.7	(0.1)	433.4	426.8	(6.6)
CFO/Management & Admin.	86.2	86.7	0.5	429.8	423.3	(6.5)
Exec. Direction & Field Admin.	40.2	40.0	(0.2)	722.5	710.9	(11.6)
Other	26.3	25.9	(0.4)	438.4	431.8	(6.6)
Total Operating Expenses	$276.1	$273.5	$(2.6)	3,873.0	3,814.0	(59.0)
Non-Credit Programs Cost	$134.7	$112.9	$(21.8)	-	-	-
Disaster Assistance	137.6	20.9	(116.7)	1,900.0	1,082.0	(818.0)
Inspector General	8.3	9.5	1.2	108.0	106.0	(2.0)
Total Operating Costs	$556.7	$416.8	$(139.9)	5,881.0	5,002.0	(879.0)

In order to support the Administrations's efforts to stimulate the economy through the small business sector, and to address the urgent need to reduce the cost of federal programs for FY 1994, we are requesting total budget authority of $693

million, 17 percent below the $835 million appropriated for FY 1993. However, if you include the proposed House supplemental for General Business Guarantee loans, our FY 1994 request would be 32 percent below the amount appropriated for FY 1993.

I would be happy to answer any questions the Committee may have.

SMALL BUSINESS ADMINISTRATION

FY 1994 CONGRESSIONAL SUBMISSION
GENERAL BUSINESS GUARANTY AND SECONDARY MARKET INITIATIVES

This budget submission proposes to reduce the subsidy rate on loans made to small businesses by private lending institutions under the 7(a) General Business Guarantee loan program. This proposal would be accomplished through two initiatives that would generate a total savings of $169 million in FY 1994 and $724 million over the next four years.

The first initiative would be to decrease the Federal guarantee on loans to an average of 75 percent. This would be accomplished by reducing the maximum guaranty percentage to not more than 80 percent of the balance of the financing outstanding at the time of disbursement except for the following: reducing the maximum guaranty percentage for the Preferred Lenders Program to not more than 75 percent; and for purchases or refinancing of real estate to not more than 70 percent. Requiring private lenders to take a greater share of the risk would increase their scrutiny of loan applications, which will eventually result in a lower default rate and better recovery rate on loans repurchased. We estimate that the savings from this initiative would be $102 million in FY 1994 and $437 million over the next four years.

The second initiative involves the secondary market on sales occurring after October 1, 1993. We would charge an ongoing fee of 50 basis points per year on the principal balance of the guaranteed portion of any loan which is initially sold into the secondary market. These fees will be established by regulation and will be collected by the fiscal and transfer agent. We estimate that the savings in FY 1994 from this second initiative will be $67 million and over the next four years it will be $287 million.

Using the $6.6 billion gross loan guarantee request for 1994, the above changes, if implemented, would "save"

$ 67 million --- new secondary market fee
85 million --- reduction of real estate guarantee to 70% (now 85-90%)
16 million --- reduction of all other non preferred lender program (PLP) guarantees to 80% (now 85-90%)
5 million --- reduction in PLP guarantees to 75% (now 80%)

$173 million

NOTE: Due to rounding, the $102 million in aggregate savings referred to in paragraph 2 above actually adds to $106 million (85+16+5).

DISASTER LOAN INTEREST RATE PROPOSAL

Under existing law, the interest rate on disaster loans for homeowners and businesses is based upon a determination of whether the disaster victim is able to obtain credit elsewhere:

a. homeowners unable to secure elsewhere, pay 1/2 the cost of money but not to exceed 4 percent;

b. homeowners able to secure credit elsewhere, pay cost of money but not to exceed 8 percent;

c. businesses unable to obtain credit elsewhere, pay 4 percent; and

d. businesses able to obtain credit elsewhere, pay the lowest of (i) private market rate for similar loans, (ii) the 7(a) guaranteed loan maximum rate, or (iii) 8 percent, and the term is limited to a maximum of 3 years.

Churches, schools and other eleemosynary institutions pay the full cost of money to the Government.

The budget submission proposes to increase the interest rate on all disaster loans to the Treasury's cost of money plus 1 point.

FY 1994 CONGRESSIONAL SUBMISSION
PROGRAM LEVEL
($ IN MILLIONS)

	FY 1992 ACTUAL		FY 1993 APPROPRIATION		FY 1994 REQUEST	
	SBA SHARE	TOTAL	SBA SHARE	TOTAL	SBA SHARE	TOTAL
DIRECT BUSINESS LOANS						
HANDICAPPED	$11.8	$11.8	$11.7	$11.7	$7.9	$7.9
VETERANS	16.6	16.6	16.2	16.2	10.5	10.5
ECONOMIC OPPORTUNITY	16.8	16.8	9.0	9.0	6.3	6.3
8(A) LOANS	4.8	4.8	4.8	4.8	5.0	5.0
MESBIC 1/	12.1	12.1	18.7	18.7	19.3	19.3
MICRO LOANS	12.7	12.7	31.3	31.3	33.7	33.7
MICRO LOANS CARRYOVER	-	-	33.7	33.7	-	-
DIRECT TOTAL	$74.8	$74.8	$125.4	$125.4	$82.7	$82.7
GUARANTEED BUSINESS LOANS						
GENERAL BUSINESS	$4,553.1	$5,624.3	$2,777.9	$3,250.1	$4,941.8	$6,589.0
GENERAL BUS. CARRYOVER	-	-	297.4	367.9	-	-
GEN. BUS. PROPOSED SUPP.	-	-	1,941.5	2,575.6	-	-
502 DEVELOP. CO	26.6	32.5	31.7	39.6	117.2	146.3
504 DEVELOP. CO.	622.8	622.8	700.0	700.0	761.2	761.2
SBIC 2/	60.1	60.1	163.2	163.2	167.7	167.7
MESBIC	12.3	12.3	17.4	17.4	17.9	17.9
GUARANTEED TOTAL	$5,274.9	$6,352.0	$5,929.1	$7,113.8	$6,005.8	$7,682.3
TOTAL BUSINESS	$5,349.7	$6,426.8	$6,054.5	$7,239.2	$6,088.5	$7,765.0
DISASTER LOANS - DIRECT						
DISASTER LOANS	$781.7	$ 781.7	$ 391.9	$ 391.9	$390.3	$390.3
DISASTER LOANS CARRYOVER	-	-	1,772.5	1,772.5	-	-
DISASTER TOTAL	$781.7	$781.7	2,164.4	2,164.4	$390.3	$390.3
TOTAL AGENCY CREDIT	$6,131.4	$7,208.5	$8,218.9	$9,403.6	$6,478.8	$8,155.3
DIRECT	856.5	856.3	2,289.8	2,289.8	473.0	473.0
GUARANTEED	5,274.9	6,352.0	5,929.1	7,113.8	6,005.8	7,682.3
OTHER PROGRAMS						
SURETY BOND GUARANTEES	$848.3	$1,034.4	$1,511.2	$1,843.7	$1,552.1	$1,893.5

1/ Original FY 1994 program level of $14.4 was changed to reflect technical adjustment in the subsidy model.
2/ FY 1994 includes the Participating Securities program.

FY 1994 CONGRESSIONAL SUBMISSION
BUDGET AUTHORITY AND OUTLAYS
($ IN THOUSANDS)

BUDGET AUTHORITY	FY 1992 APPROP.	FY 1993 APPROP.	FY 1994 REQUEST
SALARIES AND EXPENSES	$235,811	$248,800	$227,494
TRANSFER FROM BUS. LOAN PROGRAM	110,410	97,101	99,723
TRANSFER FROM DIS. LOAN PROGRAM	228,000	78,000	80,106
TOTAL S&E (Regular)	574,221	423,901 1/	407,323
INSPECTOR GENERAL	10,000	8,300	9,454
BUSINESS LOAN SUBSIDIES	348,274	234,399 2/	212,987
BUSINESS LOAN PROPOSED SUPPLEMENTAL	-	140,883	-
DISASTER LOAN SUBSIDIES	630,030	80,657 2/	49,925
DISASTER LOAN CONTINGENCY	75,000	75,000	-
SURETY BONDS	14,600	13,020	13,372
AGENCYWIDE	$1,652,125	$976,160	$693,061
OUTLAYS			
SALARIES AND EXPENSES	$214,530	$261,537	$241,016
TRANSFER FROM BUS. LOAN PROGRAM	110,410	97,101	99,723
TRANSFER FROM DIS. LOAN PROGRAM	228,000	78,000	80,106
TOTAL S&E (Regular)	552,940	436,638 1/	420,845
INSPECTOR GENERAL	9,751	8,250	9,327
BUSINESS LOAN SUBSIDIES	202,189	264,707 3/	314,559
DISASTER LOAN SUBSIDIES	72,356	336,339	211,034
SURETY BONDS	21,415	10,965	16,600
AGENCYWIDE	$858,651	$1,056,899	972,365

1/ Excludes all carryover authority from FY 1992: Business Loan Program - $5,714; Disaster Loan Program - $117,594 and; SBDC - $1,261.
2/ Excludes carryover authority from FY 1992: Business Loan Program - $25,493; Disaster Loan Program - $364,779.
3/ Excludes outlay estimate for proposed supplemental.

SELECTED SALARIES AND EXPENSES ITEMS

($ IN MILLIONS)

Program	1993 Approp	1994 Request
SBDC	67.0	67.0
White House Conference	2.5	2.5
SBI	3.0	2.9
PASS	1.1	1.1
SCORE	3.1	3.1
7(j)	8.1	8.1
Advocacy data base	1.5	1.5
Veterans Outreach	.4	.4
Int'l Trade Outreach	.5	.5
Women's Tech. asst	1.5	1.5
Women's Council	.5	.5
SBDC Technical Asst	.9	.7
Natural Resources Development	16.0	16.0
SBDC Central Europe	1.5	1.1
Computer	3.5	3.5
NFC Cross-Servicing	.7	.7
Vulnerability Studies	.5	.5
Financial Systems Upgrade	.5	.5
Credit Reform	.2	.2
Micro-Loan Tech. Asst.	6.0	6.0
SUBTOTAL	119.0	118.3
Other Ear Marked Items	19.8	0
TOTAL	138.8	118.3

FY 1994 CONGRESSIONAL SUBMISSION
SUBSIDY RATE

	FY 1992 APPROP.	FY 1993 APPROP	FY 1994 CURRENT SERVICES	FY 1994 REQUEST
DIRECT LOAN SUBSIDY RATES (IN PERCENT):				
- HANDICAPPED ASSISTANCE LOANS	36.36	25.71	39.12	39.12
- VETERANS	30.30	17.87	28.49	28.49
- ECONOMIC OPPORTUNITY LOANS	30.30	17.83	25.84	25.84
- SECTION 8(A) LOANS	30.30	17.87	17.53	17.53
- MESBIC	44.33	38.06	37.80	37.80
- MICRO LOANS	17.00	15.95	15.25	15.25
WEIGHTED AVERAGE SUBSIDY RATE	31.26	20.61	25.43	25.43
GUARANTEED LOAN SUBSIDY RATES (IN PERCENT):				
- SECTION 7(A) LOANS	4.85	5.47	4.92	2.35
- SECTION 502 DEVELOPMENT CO. LOANS	5.95	5.58	1.55	1.55
- SECTION 504 DEVELOPMENT CO. LOANS	0.49	0.54	0.51	0.51
- SMALL BUSINESS INVESTMENT CO. LOANS	14.29	15.40	15.39	15.39
- MESBIC	27.30	28.88	28.83	28.83
WEIGHTED AVERAGE SUBSIDY RATE	4.56	5.27	4.57	2.50
DISASTER LOAN PROGRAM SUBSIDY RATES (IN PERCENT):	33.93	20.58	27.61	12.79

OPENING STATEMENT OF JOHN J. LaFALCE, CHAIRMAN
COMMITTEE ON SMALL BUSINESS

HEARING ON SBA's BUDGET

MAY 27, 1993

Today the Committee resumes its hearings on the adequacy of the budget for the Small Business Administration, primarily with reference to fiscal year 1994, but also as to the remainder of the current fiscal year.

Last week the Committee was pleased to receive testimony from the newly confirmed Administrator of the Small Business Administration, the Honorable Erskine Bowles of North Carolina. The principal focus of last week's hearing was the status of SBA's financial assistance programs and the agency's ability to help small firms overcome the credit crunch. The Committee is also very concerned with the other major SBA programs. Thus we are pleased to have representatives from the SBDC program and the venture capital programs, both of which are very important to the agency. However, particularly in light of the continued shutdown of the 7(a) loan program due to its having exhausted all funding for the year, the emphasis on the agency's financial programs will continue today.

I do want to note for the record, however, that yesterday the House approved H.R. 2118, which will provide $181 million to support an additional $3.3 billion in loan guarantees and carry the program through the year. The Senate still needs to act.

Until this issue is finally resolved, small businesses will continue to be denied critical resources. I will continue to press for the earliest possible action.

As part of next year's budget request, this administration, as administrations in the past have done, is proposing additional fees on the guaranteed loan programs and a reduction in the percentage of the loan guaranteed by the Government.

But this is not being done in a vacuum. It is part of a broader effort focused on serious deficit reduction.

Unlike previous Administrations, this Administration is proposing a serious and credible deficit reduction package. As part of that effort, the SBA is being asked in good faith to come up with $169 million in savings. No one would be suggesting a fee or the other program changes that are now on the table if our government did not need the resources to reduce the deficit. The impact of these changes is substantial, from the perspective of cost savings. The Congress will have appropriated over $375 million to support a $6.9 billion loan guarantee program in 1993. The program changes being suggested could theoretically allow us to appropriate only a fraction of that amount -- $155 million -- to support a program of almost comparable size.

This Committee understands that no bank will want to pay a fee if it doesn't have to; nor would any bank prefer a 75% guarantee to a larger one. That goes without saying. But it is not unreasonable to charge a fee for service; and some would argue that there are substantial incentives to participate in the SBA loan guarantee program, even with the recommended changes.

It is for this Committee to determine whether we are striking the proper balance. The public policy question is what, if any, of these or other program changes can be effected without putting the integrity of the loan guarantee program -- and the small businesses it serves -- at risk.

As we attempt to make that judgment, we must remember that deficit reduction is not our only goal. The suggested changes may in fact not be compatible with objectives of equal or even greater importance to this Administration -- eliminating the credit crunch which has plagued small business for so long, and allowing small business to be the catalyst for growth it has the potential to be. If the recommended approach is not compatible with those goals, we must seek a better way.

The fundamental question, then, is the impact on the small business borrower. As the Committee considers the impact of fee increases and guarantee reductions, we need to ascertain just what such changes would do to those small business borrowers who

need this loan money the most. My concerns focus particularly on those who already have a very difficult time obtaining credit: the small borrower who needs only $30,000, $50,000, or $60,000; the minority borrower; and the emerging woman business owner.

I am hopeful that we can find other sources than the SBA budget for achieving the necessary deficit reduction -- SBA cannot be expected to bear the brunt of this challenge. If not, we must seek changes that will not impair the fundamental integrity of the program.

When we conclude today's hearing, I hope we have received the professional judgment of our expert witnesses on these important questions.

Do other Members have opening remarks?

STATEMENT OF REPRESENTATIVE JAN MEYERS
"SBA FY 94 BUDGET PROPOSAL"
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
MAY 27, 1993

Mr. Chairman, in the interests of time, I will not make a lengthy opening statement today. I thank you for assembling many able witnesses this morning to testify and render their opinions on the Administration's proposed FY 94 budget for the Small Business Administration.

As we heard last week from our new Administrator, Erskine Bowles, the Administration would like to make some changes in SBA loan programs, most notably the 7(a) general business loan guarantee program, to reduce the taxpayer's exposure, reduce loss rates, and provide more loans per appropriated dollar. These changes include reducing the government guarantee level from an average of 81 percent to 75 percent, and charging a .5 percent fee on the unpaid guaranteed principal balance for sales of loans in the secondary market. Such proposals are not necessarily new, having been put forward unsuccessfully by previous Administrations. However, I believe we ought to carefully consider these proposals, and the input of our witnesses, to determine whether such initiatives could be implemented without imposing further harm the small business lending climate.

In addition to the 7(a) program, we will hear from knowledgeable witnesses on the proposed funding levels for the 502 and 504 loan programs, the Small Business Investment Company program, the Small Business Development Centers, and the many other outreach and business assistance programs conducted through the SBA. I look forward to all of your testimony, as it will be very helpful to this Committee in assessing the SBA budget proposal. Thank you.

STATEMENT FOR
CONGRESSMAN FLOYD H. FLAKE
BEFORE THE COMMITTEE ON SMALL BUSINESS
MAY 27, 1993

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE SMALL BUSINESS COMMITTEE. I WOULD LIKE TO WELCOME OUR PANEL OF WITNESSES AND I LOOK FORWARD TO THEIR INSIGHT RELATING TO THE SMALL BUSINESS ADMINISTRATION'S BUDGET REQUEST.

LAST WEEK WE HAD THE OPPORTUNITY TO HEAR FROM THE ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, ERSKINE BOWLES. DURING THAT TIME THE ADMINISTRATOR PROVIDED US WITH SOME INSIGHT AS TO THE RATIONALE BEHIND THE SBA's BUDGET REQUEST. NOW I WELCOME OUR WITNESSES AND HOPE THAT THEY CAN PROVIDE US WITH THE INDUSTRY PERSPECTIVE ON THIS BUDGET AND ITS AFFECT ON SMALL BUSINESSES LENDING AND INVESTMENT.

WHILE I CONCUR WITH THE ASSERTION THAT WE MUST ALL SACRIFICE FOR THE SAKE OF DEFICIT REDUCTION, WE CANNOT UNNECESSARILY HARM SECTORS OF OUR ECONOMY THAT HAVE PROVEN SUCCESSFUL IN SPURRING GROWTH AND JOB OPPORTUNITY. WITH THAT IN MIND, I AM INTERESTED IN THE WITNESSES PERSPECTIVE RELATING TO REDUCING THE FEDERAL GUARANTEE ON LOANS FROM AN AVERAGE OF 81 PERCENT TO AN AVERAGE OF 75 PERCENT. THIS INITIATIVE IS AIMED AT SAVING $102 MILLION IN 1994, BUT WILL THE CONSEQUENCES OF SUCH AN ACTION OUTWEIGH THE GAINS?

AS WE LOOK AT THE ADMINISTRATION'S BUDGET PROPOSAL, I WANT TO BE CLEAR ON HOW THE SPECIFIC INITIATIVES MAY AFFECT OUR NATIONS HISTORICAL JOB CREATOR. WE ARE ALL WELL AWARE OF IMPORTANCE OF THE SMALL BUSINESS SECTOR; NOW WE MUST SUPPORT THE NECESSARY EFFORTS

TO STRENGTHEN THEM.

AGAIN, I WELCOME OUR WITNESSES AND AWAIT THEIR TESTIMONY.

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OPENING STATEMENT OF RONALD K. MACHTLEY
COMMITTEE ON SMALL BUSINESS
HEARING ON THE SMALL BUSINESS ADMINISTRATION'S BUDGET
MAY 19, 1993

Thank you, Mr. Chairman. And I thank the panel for agreeing to come here today to testify on the Small Business Administration's budget.

The Clinton Administration has outlined numerous initiatives that are intended to help small businesses. Indeed, with 88 percent of all registered companies classified as small businesses, it is clear that we must focus on helping them stay competitive in an ever changing market.

Let me state first off that I am a strong supporter of numerous SBA initiatives that are designed to provide small businesses with management and technical assistance, and to assist these businesses in acquiring much-needed capital in order to expand operations or enhance research and development efforts.

Given the ongoing credit crunch throughout New England, and in many other parts of the country, it is important that small businesses have alternatives to traditional lending opportunities. I find this especially true in my state of Rhode Island which, according to the SBA publication "The State of Small Business: 1992," is ranked number 1 throughout the nation in small business failures. The SBA 7(a) program was specifically designed to encourage banks to lend to more "risky" businesses. This program has helped provide hundreds of Rhode Island entrepreneurs with the capital needed to start and stay in business. In 1993, the Rhode Island SBA office has already handled over 80 loans worth almost $19 million. So, as you can see, the SBA plays a major role in lending money to needy Rhode Island businesses.

Given this important role, I am a bit concerned about the Administration's proposal to reduce the guarantee level for 7(a) loans. Mr. Wilfong, of the American Bankers Association, captured the essence of the problem behind this proposal: "By mandating a transfer of additional risk from SBA back to the lender, the SBA, in essence, is stating that it is looking for more credit-worthy borrowers to include in it's portfolio of guaranteed loans. This would suggest that the SBA is moving farther away from it's original purpose of helping undercapitalized small business ventures, and, instead, is more interested in bank eligible credits, many of which are currently being funded by the banking community without a guarantee." There is no doubt in my mind that if guarantee levels are reduced, banks, especially in states like Rhode Island where there is a history of bank failure, will be less willing to approve loans to more risky start-ups.

Rather than hoping for lending activity to increase through reductions in SBA loan guarantees, I would suggest that a more sure-fire way of increasing lending is to simply make sure that the 7(a) loan program is fully-funded. Last year our committee authorized funding to support $6.2 billion in 7(a) loan guarantees. However, appropriators felt that the need was much less - about $3 billion less. Demand for this program is running at $9 billion a year so we clearly need to support authorization levels at the very least.

I would also suggest that more needs to be done to remove regulatory barriers in the banking industry. Legislation, such as the Economic Growth and Financial Institutions Regulatory Paperwork Reduction Act of 1993, would increase the amount of credit available to small and medium sized businesses by alleviating the banking industry of regulatory micromanagement. This proposal represents a comprehensive approach to promoting economic growth and eliminating regulatory red tape without threatening the soundness of the nation's financial institutions. By minimizing the government's role in regulatory oversight, this legislation would help ease the credit crunch that small businesses are still experiencing.

Another idea that I support, which is gaining steam in Congress and the Private sector, is the creation of a secondary market for small business loans. The sale of securities by the private sector, which are backed by small business loans, would create a strong secondary market benefiting bankers, small businesses and investors. In 1984, regulatory impediments to selling securities were removed from the housing industry through the formation of a secondary market which pooled residential mortgages. Creating such a market for small business loans would encourage capital investment rather than discouraging it under current regulations.

There are other programs under the SBA which deserve notice; like the Small Business Development Centers. I have been very impressed with Rhode Island's Small Business Development Center Program (RISBDC) which is operated out of Bryant College in Smithfield. This program, administered with SBA funds and supplemented with state and private contributions, provides low-cost training and one-on-one consulting on a variety of business topics. In addition, RISBDC provides procurement assistance to help companies sell goods and services to the federal government as well as assisting businesses in development of R&D proposals for submission under the Small Business Innovation Research Program. Most notably, RISBDC runs a highly successful Entrepreneurship Training Program which helps assist displaced workers in developing new businesses. With the eminent defense draw-down, RISBDC is also working closely with the Rhode Island Department of Economic Development and other parties to develop a smoother transition from a defense to civilian economy.

In the coming months, our committee will be presented with the task of passing legislation to keep the SBA in business. If we are genuinely concerned about small businesses acquiring the credit they need to fuel our economy, it is clear that we have to take immediate action to reduce regulatory micromanagement and to increase lending to small businesses through the SBA and the private sector. I believe that it would be penny wise and pound foolish to neglect the financing needs of small firms at a time when Rhode Island, and the rest of the nation, desperately needs the jobs and economic development small businesses generate. Thank you, again, gentlemen for coming before us today to address the effects future government policies will have on small businesses. I look forward to hearing your testimony.

STATEMENT BY CONGRESSMAN JIM RAMSTAD
BEFORE THE HOUSE SMALL BUSINESS COMMITTEE
May 27, 1993

HEARING ON THE SBA'S FY 1994 BUDGET REQUEST

Mr. Chairman, I am pleased to welcome this distinguished panel of witness today to discuss the SBA's budget request for fiscal year 1994.

I must say I was extremely impressed with the new SBA Administrator, Erskine Bowles, when he testified before this Committee recently. It certainly appears his background will give him the unique ability to provide the leadership we need at the SBA.

Mr. Chairman, we've all heard from bankers and small businesses in our district frustrated about the underfunding of the SBA this year. Unfortunately, the SBA budget is consistently caught in the middle of a political battle.

While this issue touches on only one portion of the SBA budget issue, it is particularly germane this week as Congress considers supplemental funding for the 7 (a) program.

As we all know, the House passed H.R. 4111, the Small Business Credit Crunch Relief Act, during the last session. The bill authorized Congress to appropriate an amount to allow the SBA to guarantee up to $6.2 billion in loans during Fiscal Year (FY) 1993.

Because the appropriators chose to fund only a portion of the program -- knowing full well that demand for SBA loans would be high in the midst of an economic downturn -- the SBA was forced to seek supplemental appropriations to make up the difference.

I find it extremely hard to believe that six-tenths of one percent could not have been trimmed from the $23 billion overall appropriations bill -- particularly for a cost-effective program like 7 (a) -- and the program could have been funded without adding to the deficit through a supplemental spending bill.

As we all know, these supplemental appropriations bills are targets for every special interest group in the Congress -- they become Christmas trees. Worthy and needed programs like 7 (a) get caught in the middle.

I certainly hope that as we examine the SBA's budget this year, the problem we saw this year -- and see so often -- can be avoided and the SBA can do what it was designed to do, namely provide the resources to our small businesses to help them do what they do best -- provide jobs.

Mr. Chairman, I certainly look forward to reviewing the SBA's specific budget request with today's witnesses.

STATEMENT OF CONGRESSMAN SAM JOHNSON

COMMITTEE ON SMALL BUSINESS

MAY 27, 1993

THANK YOU MR. CHAIRMAN. I'D LIKE TO THANK THE MEMBERS OF OUR DISTINGUISHED PANEL FOR THEIR PARTICIPATION IN TODAY'S HEARING. I'D ALSO LIKE TO WELCOME TWO FELLOW TEXANS TO WASHINGTON -- JOHN SHIVERS FROM FT. WORTH AND DOUGLAS KADISON FROM AUSTIN.

AS WE ADDRESS REAUTHORIZING THE SMALL BUSINESS ADMINISTRATION, WE MUST CONCENTRATE ON GETTING THE MOST BANG FOR THE BUCK. THIS MEANS STREAMLINING ADMINISTRATIVE COSTS, WITHOUT JEOPARDIZING THE QUALITY OF LOAN SERVICES TO AMERICAN SMALL BUSINESSES.

ALTHOUGH I AM OPTIMISTIC THAT THE SBA PROPOSES TO REDUCE ADMINISTRATIVE EXPENSES BY 14% OVER THE NEXT FIVE YEARS, I'M CONCERNED THAT THE SBA IS NOT EFFECTIVELY PRIORITIZING ITS PROGRAMS. FOR

INSTANCE, IN 1993 THE SBA RECEIVED $2.5 MILLION DOLLARS FOR THE NATIONAL WHITE HOUSE CONFERENCE. ALTHOUGH NO CONFERENCE HAS BEEN HELD SINCE 1986, THE 1994 BUDGET REQUESTS AN ADDITIONAL $2.5 MILLION DOLLARS. I DON'T THINK IT IS GOOD POLICY TO AUTHORIZE ADDITIONAL FUNDING YEAR AFTER YEAR FOR A CONFERENCE WHICH WILL NOT REALISTICALLY MATERIALIZE UNTIL 1995.

IN ADDITION, LAST NIGHT WE WITNESSED A TWISTING OF ARMS TO PASS THE $14 MILLION DOLLAR SBA TREE PROGRAM. WHEN IS THE SPENDING SPREE GOING TO STOP? DO SMALL BUSINESSES, WHO WAIT MONTHS TO QUALIFY FOR LOANS, REALLY NEED A TREE PROGRAM OR A WHITE HOUSE CONFERENCE. IN MY OPINION, THE MONEY ALLOCATED TO THESE PROGRAMS WOULD BE BETTER SPENT TO LEVERAGE ADDITIONAL LOANS.

KEEPING OUR CURRENT ECONOMIC SITUATION IN MIND, I CHALLENGE THIS COMMITTEE TO PRIORITIZE THE SBA'S REQUESTS TO ENABLE US TO BALANCE THE BUDGET, WHICH WE ALL KNOW IS BEST FOR AMERICAN SMALL

BUSINESSES. I LOOK FORWARD TO THE PANEL'S COMMENTS ON THESE AND OTHER ASPECTS OF THE BUDGET.

WRITTEN STATEMENT

of

ANTHONY R. WILKINSON

PRESIDENT

NATIONAL ASSOCIATION OF
GOVERNMENT GUARANTEED LENDERS, INC.

FOR THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

May 27, 1993

Mr. Chairman and other members of the Committee, my name is Tony Wilkinson. I am President of the National Association of Government Guaranteed Lenders, Inc., commonly known as NAGGL. NAGGL represents those members of the lending community who are active participants in the SBA 7(a) loan program. NAGGL's membership accounts for approximately 70% of all the SBA 7(a) loans that are approved annually.

Prior to accepting my current position with NAGGL, I spent 13 years with a commercial bank where my primary responsibility was managing the bank's SBA loan department. I have seen first hand how valuable the SBA loan programs are to small businesses, lenders and local communities.

I appreciate the opportunity to again come before the Committee and discuss the SBA loan programs, the Administration's budget request for fiscal year 1994, and the current funding crisis. These hearings provide an opportunity to highlight the SBA, which through its loan programs, provides vital access to capital for our nation's small businesses.

NAGGL is disappointed that the Administration's budget request outlines proposals that serve only to heighten the effects of the credit crunch on the small business sector. The budget request has two line items of particular concern to the 7(a) lending community:

1) A decrease in the 7(a) average guaranty percentage to 75% from 81%, and
2) Collection of a secondary market fee of .5% per annum.

The proposed reduction in guaranty percentages is a proposal we have seen many times from previous Administrations. Thanks to the efforts of this Committee, those proposals have been rejected in the past, and I hope this proposal will also be rejected. Reductions in the guaranty percentage will simply serve to reduce capital availability to small business. Banks and other lenders simply have limited resources that can be placed in a portfolio of long-term loans, the kinds of loans needed by small businesses. Assuming a 90% guaranty, a lender with $1,000,000 in funds available for long-term loans, can leverage that into $10,000,000 in guaranteed loans through the SBA. Reducing the guaranty percentage to 80%, reduces the leveraged pool of funds to $5,000,000, and a reduction to a 75% guaranty would reduce the leveraged pool of funds to $4,000,000. As you can see, a reduction in the guaranty percentage leads to a reduction in the availability of long-term loan funds. Under this scenario, many worthy small business borrowers would not have access to needed long-term financing, again heightening the effects of the credit crunch on small business.

The budget proposal indicates the guaranty percentage decrease would lead to better lender scrutiny, lower defaults and lower loan losses. I strongly believe that the SBA loss rate is already sufficiently low. The proposed reductions in the guaranty percentage would only serve to exclude otherwise worthy borrowers from obtaining credit, and would disproportionately impact smaller lending institutions. **NAGGL urges this Committee to oppose any effort to decrease the guaranty percentage.**

The second budgetary initiative of collecting an on-going user fee of .5% per annum runs contrary to the reason the secondary market was established. The secondary market for SBA loans has proven to be an excellent vehicle for small businesses to access capital markets, yet the budget proposal would serve to penalize borrowers and lenders who would access it. Ironically Mr. Chairman, while you and other members of Congress search for ways to expand secondary market capital accessibility for small business, the Administration has brought forth a proposal that could constrict a secondary market that is working quite well.

Evidently, it is the belief of some that lenders are "getting rich" on secondary market sales. To check these assumptions, I compared the gross income derived from an average $250,000 SBA loan, made for the average 12 years, with the average 81% and sold into the secondary market at the average price versus a comparable size loan held in portfolio. Please understand that a lender derives income from one of two ways: either collecting the interest income or selling the loan and collecting fees. In the case of an SBA loan, it is a combination of interest income on the unguaranteed/retained piece plus fees on the guaranteed/sold piece.

My calculation found that the net present value of the gross income stream on the SBA loan fell far short of the net present value on the portfolio loan ($39,310 vs. $56,986). This calculation verifies why only one-half of the loans originated each year are sold into the secondary market. Many lenders simply cannot fund long-term loans from their short-term deposit

base. The secondary market, as intended, provides lenders with access to liquidity, rather than providing a get-rich-quick scheme. If that were the case, one symptom would be a much higher loan sale rate than 50%.

Another concern I have heard is that the bulk of SBA loans are made at the legal maximum rate of Prime + 2.75%. This is simply not the case. For fiscal year 1992, according to the SBA, only 26% of the loans were made at an interest rate of Prime + 2.5 to Prime + 2.75%. The average loan interest rate last year was Prime + 2%, with 11% of the loans being made at fixed rates of interest, and an additional 40% of the loans being made at Prime + 2% or less. The fact is that the bulk of SBA loans are made at rates less than the maximum interest rate of Prime + 2.75%. The next question would then be: How much would the average interest rate increase to the *borrower* should the proposed structural changes be enacted?

Before the Administration takes any action on any structural changes to the program, I would suggest that the subsidy model be carefully reviewed, as NAGGL believes we have found a flaw in the calculation. The subsidy model for the SBA 7(a) program is overstating the cost of the program to the government by continuing to fictitiously accrue interest on loans in liquidation. At charge-off date, the SBA charges off both principal and accrued interest, even though the interest portion does not require a true advancement of funds. This overstates the actual losses incurred by the government, and negatively impacts future users of the program by reporting a higher-than-actual subsidy rate.

In the private sector, lending institutions are required to place loans on non-accrual status when a loan becomes 90-days delinquent. After a loan is liquidated, the private sector only charges off the remaining principal balance, as no further interest has been accrued. The SBA should modify their accounting practices to reflect this lending industry standard, and begin placing defaulted loans on non-accrual, for accounting purposes, at the date they repurchase the guaranteed portion. This will more accurately reflect the government's required outlays, and will reduce the subsidy rate for this most-important program.

The two proposed budget initiatives would supposedly reduce the subsidy rate for the SBA 7(a) program from 4.92% to 2.35%, or a 52% decrease in the subsidy rate. This would translate into a significant increase in the cost of the program to borrowers and lenders. If we are trying to foster growth in the small business sector, why are we proposing to raise their costs of obtaining capital? It would be in the best interests of the Administration, borrowers and lenders if the subsidy model was first refined, and then consider other modifications only after the Administration has carefully studied the impacts which would result from the proposed structural changes.

The 1994 budget requests only a $155 million appropriation for the SBA 7(a) loan program. The Administration has gone on record supporting HR 2118, the supplemental appropriations bill currently working its way through the House of Representatives. That bill would add $181 million in appropriations, to the $196 million already used this year, to support lending for the last five months of this fiscal year, taking total loan authority for the year to $6.9 billion. I find it contradictory that the Administration would support the current supplemental appropriation while proposing an almost 60% appropriation cut for next year. I also find it contradictory that the Administration forecasts a decline in SBA 7(a) lending, something that has not occurred in many years.

The Administration's budget request has only addressed the outlay side of the equation. Where is the discussion about the revenues these small business borrowers create? Any good business decision is based upon a cost-benefit analysis, not just a cost analysis. If the government's analysis were to include the payroll, individual and corporate tax revenues generated by SBA borrowers, I am confident you would find that the benefits created by this program more than justify its costs.

The Administration has also failed to calculate the income and tax effect that the proposal would have on financial institutions. For example, let's look at the Charlotte State Bank in Port Charlotte, Florida, a small bank that originated approximately $7.5 million last year in SBA 7(a) loans. Had

the Administrations budget proposal been in place last year, the banks' revenues in their SBA operation would have decreased by 36%, their federal income taxes paid would have decreased 64%, and the number of loans the bank would have been able to make would have declined. This bank, as many others, absorbs some or all of the borrowers guaranty fee, appraisal fees and/or other loan closing costs. Rest assured that if the banks' revenues are cut 36% they will look for other ways to recoup the loss, i.e., higher interest rates, discontinue paying the guaranty fee, etc.

Ironically, the Administration's budget proposal that is supposedly designed to save money for the government, will, in my opinion, lead to larger budget deficits as small businesses will find it increasingly difficult to finance their operations. The government coffers would lose some $60 million from reduction in lender income taxes plus the lost tax revenues from those small businesses that could not start, expand or grow because they could not find financing. Borrowers looking for smaller loans, loans that are typically more risky and more expensive, will find themselves squeezed out of the program, as lenders naturally fund those loans (with limited SBA resources) that are the easiest to complete and that are the most cost effective. Smaller banks will disproportionately harder with the changes. With all of the foregoing in mind, **NAGGL urges this committee to strongly oppose the Administration's proposed structural changes to the program that would serve to further restrict capital availability to small businesses and increase the federal deficit.**

NAGGL continues to receive frequent requests for information about the 7(a) program from lenders throughout the country. Lenders continue to dedicate additional resources to improving their SBA programs. Groups such as NAGGL and NADCO are placing a higher emphasis on the SBA loan programs by holding training sessions across the country. Needless to say, the budget request undermines all these efforts to appropriately finance small business. The $155 million 7(a) budget proposal simply will not provide enough loan authority, under any program structure, to meet next years anticipated demand by the nation's small businesses.

Earlier this year the Administration, in conjunction with the federal banking regulators, unveiled a program of regulatory and administrative changes that are to help the flow of credit to smaller enterprises. These new guidelines allow well-managed and adequately capitalized institutions to create a pool of loan funds of up to 20% of their total capital, and these loans would require only minimal documentation. Unfortunately, this program is not of the magnitude needed by small business, and does not match the effectiveness of the current SBA 7(a) program. From the Interagency Initiative/SBA Portfolio Comparison that accompanies this testimony, please notice that the amount of funds in a lenders "interagency loan pool" correlates to, on average, approximately 2% of their loan portfolios. And not every financial institution is eligible to participate. Rather than generating new loans to small business, the bankers I spoke with see this as a safety outlet to reclassify those performing loans, already on their books, that have been previously criticized by the bank regulators.

On the same schedule, please notice the impact that the SBA program has on these financial institutions. The portfolios are larger than the "interagency pool" would provide, and the SBA portfolios are not arbitrarily capped. In my opinion, funding the SBA program will be significantly more beneficial to the small business sector.

The good news for the small business sector has been the availability of credit through the SBA's loan programs. Lenders and small business borrowers are turning to the SBA in increasing numbers, as the SBA's 7(a) and 504 loan programs are virtually the only sources of long-term financing for small business. Through the first half of FY '93, loan volume in these two programs was up 30% over the same period in FY '92. And the increase in demand is expected to continue throughout the rest of this fiscal year and into the future.

That brings us to the immediate problem. The fiscal year '93 appropriation for the SBA 7(a) loan program has proved insufficient to meet the level of borrower demand. Unless there is additional funding appropriations, this vital loan program could be irreparably damaged in the near future. This disruption in the availability of SBA guaranteed loans is more than just an inconvenience. The scarcity of guaranty authority forces the delay or outright cancellation of lender commitments and small business expansion plans. Many small businesses will find they are unable to perform contracts without the availability of credit. Lenders are considering layoffs due to the uncertainty of when additional loan funds will be available. In

some cases, lenders are providing short-term interim financing until a guaranteed loan could be made. This means double documentation, more time, expense and uncertainties for lenders and their small business customers. **I urge this Committee to take all the necessary steps so that we may see a quick resolution of this problem.**

In my opinion, the SBA loan programs are well managed. These programs level out the playing field for smaller companies by providing them the same access to affordable, long-term credit enjoyed by larger corporations. This is done at a minimum of federal cost and at a minimum of interference in the free market system. NAGGL commends the Committee for its past support of the SBA and its loan programs, and we urge increased support now as the small business sector plays a most important role in these economic times. We must find ways to encourage the entrepreneurial spirit, encourage people to go into business and create jobs, develop technology, employ people and generate tax revenues. Restricting small businesses access to capital or raising the cost of capital would be counterproductive.

On behalf of the Directors, all the members of NAGGL and the small business borrowers we serve, I thank you for this opportunity to again come before this Committee. Mr. Chairman, NAGGL pledges its active cooperation in working with you and the Committee on small business financing issues.

Interagency Initiative/SBA Portfolio Comparison

Institution	* $ Capital	20% Interagency Pool	* $ Loan Portfolio	Interagency Portfolio Impact %	$ SBA Portfolio	SBA Portfolio Impact %
Stillwater National Bank Stillwater, OK	21	4.2	262	1.6	28	10.7
American Bank of Commerce Wolfforth, TX	8	1.6	68	2.4	11	16.2
First National Bank Olathe, KS	13	2.6	84	3.1	25	29.8
Guardian State Bank Salt Lake City, UT	5	1.0	34	2.9	56	164.7
United Bank of Michigan Grand Rapids, MI	8	1.6	76	2.1	47	61.8
Sacramento Commercial Bank Sacramento, CA	8	1.6	92	1.7	120	130.4
United New Mexico Bank Las Cruces, NM	3.5	.7	42	1.7	29	69.0

*Source: Polk Bank Directory

$ in millions

NAGGL--Net present value of SBA loan cash flow--sale for premium

Loan Amount:	$250,000	Term:	144 months
Payment amt:	2,706.13	Int rate:	8.00%
Guaranteed amt (81%):	$202,500	Premium:	9.00%

Mo	Ending Principal Balance	Sold Balance (@ 81%)	Interest Spread (1)	Serv. Fee (2)
0	250,000.00	202,500.00		
1	248,960.54	201,658.03	178.13	168.75
2	247,914.14	200,810.45	177.38	168.05
3	246,860.77	199,957.22	176.64	167.34
4	245,800.38	199,098.31	175.89	166.63
5	244,732.91	198,233.66	175.13	165.92
6	243,658.34	197,363.25	174.37	165.19
7	242,576.59	196,487.04	173.61	164.47
8	241,487.64	195,604.99	172.84	163.74
9	240,391.43	194,717.05	172.06	163.00
10	239,287.90	193,823.20	171.28	162.26
11	238,177.02	192,923.39	170.49	161.52
12	237,058.74	192,017.58	169.70	160.77
13	235,933.00	191,105.73	168.90	160.01
14	234,799.76	190,187.80	168.10	159.25
15	233,658.96	189,263.75	167.29	158.49
16	232,510.55	188,333.55	166.48	157.72
17	231,354.49	187,397.14	165.66	156.94
18	230,190.72	186,454.48	164.84	156.16
19	229,019.19	185,505.55	164.01	155.38
20	227,839.86	184,550.28	163.18	154.59
21	226,652.66	183,588.65	162.34	153.79
22	225,457.55	182,620.61	161.49	152.99
23	224,254.46	181,646.12	160.64	152.18
24	223,043.36	180,665.12	159.78	151.37
25	221,824.19	179,677.59	158.92	150.55
26	220,596.88	178,683.48	158.05	149.73
27	219,361.40	177,682.73	157.18	148.90
28	218,117.68	176,675.32	156.29	148.07
29	216,865.66	175,661.19	155.41	147.23
30	215,605.30	174,640.29	154.52	146.38
31	214,336.54	173,612.60	153.62	145.53
32	213,059.32	172,578.05	152.71	144.68
33	211,773.58	171,536.60	151.80	143.82
34	210,479.27	170,488.21	150.89	142.95
35	209,176.34	169,432.83	149.97	142.07
36	207,864.71	168,370.42	149.04	141.19
37	206,544.35	167,300.92	148.10	140.31
38	205,215.18	166,224.30	147.16	139.42
39	203,877.15	165,140.49	146.22	138.52
40	202,530.20	164,049.46	145.26	137.62
41	201,174.27	162,951.16	144.30	136.71
42	199,809.30	161,845.53	143.34	135.79
43	198,435.23	160,732.54	142.36	134.87
44	197,052.00	159,612.12	141.39	133.94

Net present value (3) of interest spread over life of loan	$10,827
Net present value of 1% servicing fee over life of loan	10,257
Premium received from sale of guaranteed portion of loan	18,225
Total present value of cash flows	$39,310

(1) Interest spread based on cost of funds at 3.5%.

(2) Servicing fee based on 1% (annualized) of sold balance.

(3) Net present values calculated based on discount rate of 8.0%, the note rate.

45	195,659.55	158,484.23	140.40	133.01
46	194,257.81	157,348.83	139.41	132.07
47	192,846.73	156,205.85	138.41	131.12
48	191,426.25	155,055.26	137.40	130.17
49	189,996.29	153,897.00	136.39	129.21
50	188,556.80	152,731.01	135.37	128.25
51	187,107.72	151,557.25	134.35	127.28
52	185,648.97	150,375.66	133.31	126.30
53	184,180.50	149,186.20	132.27	125.31
54	182,702.24	147,988.81	131.23	124.32
55	181,214.12	146,783.44	130.18	123.32
56	179,716.08	145,570.03	129.12	122.32
57	178,208.06	144,348.53	128.05	121.31
58	176,689.98	143,118.88	126.97	120.29
59	175,161.78	141,881.04	125.89	119.27
60	173,623.39	140,634.95	124.80	118.23
61	172,074.75	139,380.55	123.71	117.20
62	170,515.79	138,117.79	122.60	116.15
63	168,946.43	136,846.61	121.49	115.10
64	167,366.60	135,566.95	120.37	114.04
65	165,776.25	134,278.76	119.25	112.97
66	164,175.29	132,981.99	118.12	111.90
67	162,563.66	131,676.57	116.97	110.82
68	160,941.29	130,362.45	115.83	109.73
69	159,308.10	129,039.56	114.67	108.64
70	157,664.02	127,707.86	113.51	107.53
71	156,008.99	126,367.28	112.34	106.42
72	154,342.91	125,017.76	111.16	105.31
73	152,665.74	123,659.25	109.97	104.18
74	150,977.38	122,291.67	108.77	103.05
75	149,277.76	120,914.99	107.57	101.91
76	147,566.81	119,529.12	106.36	100.76
77	145,844.46	118,134.01	105.14	99.61
78	144,110.63	116,729.61	103.91	98.45
79	142,365.23	115,315.84	102.68	97.27
80	140,608.20	113,892.64	101.44	96.10
81	138,839.46	112,459.96	100.18	94.91
82	137,058.92	111,017.73	98.92	93.72
83	135,266.52	109,565.88	97.65	92.51
84	133,462.16	108,104.35	96.38	91.30
85	131,645.78	106,633.08	95.09	90.09
86	129,817.29	105,152.00	93.80	88.86
87	127,976.60	103,661.05	92.49	87.63
88	126,123.65	102,160.16	91.18	86.38
89	124,258.34	100,649.26	89.86	85.13
90	122,380.60	99,128.29	88.53	83.87
91	120,490.34	97,597.18	87.20	82.61
92	118,587.48	96,055.86	85.85	81.33
93	116,671.93	94,504.26	84.49	80.05
94	114,743.61	92,942.32	83.13	78.75
95	112,802.44	91,369.97	81.75	77.45
96	110,848.32	89,787.14	80.37	76.14
97	108,881.18	88,193.75	78.98	74.82
98	106,900.92	86,589.75	77.58	73.49
99	104,907.46	84,975.05	76.17	72.16
100	102,900.71	83,349.58	74.75	70.81

101	100,880.59	81,713.28	73.32	69.46
102	98,846.99	80,066.06	71.88	68.09
103	96,799.84	78,407.87	70.43	66.72
104	94,739.04	76,738.62	68.97	65.34
105	92,664.51	75,058.25	67.50	63.95
106	90,576.14	73,366.67	66.02	62.55
107	88,473.85	71,663.82	64.54	61.14
108	86,357.54	69,949.61	63.04	59.72
109	84,227.13	68,223.97	61.53	58.29
110	82,082.51	66,486.83	60.01	56.85
111	79,923.59	64,738.11	58.48	55.41
112	77,750.29	62,977.73	56.95	53.95
113	75,562.49	61,205.62	55.40	52.48
114	73,360.11	59,421.69	53.84	51.00
115	71,143.04	57,625.87	52.27	49.52
116	68,911.20	55,818.07	50.69	48.02
117	66,664.48	53,998.23	49.10	46.52
118	64,402.78	52,166.25	47.50	45.00
119	62,126.00	50,322.06	45.89	43.47
120	59,834.04	48,465.57	44.26	41.94
121	57,526.80	46,596.71	42.63	40.39
122	55,204.18	44,715.39	40.99	38.83
123	52,866.08	42,821.52	39.33	37.26
124	50,512.39	40,915.03	37.67	35.68
125	48,143.00	38,995.83	35.99	34.10
126	45,757.83	37,063.84	34.30	32.50
127	43,356.75	35,118.96	32.60	30.89
128	40,939.66	33,161.12	30.89	29.27
129	38,506.46	31,190.23	29.17	27.63
130	36,057.04	29,206.20	27.44	25.99
131	33,591.29	27,208.94	25.69	24.34
132	31,109.10	25,198.37	23.93	22.67
133	28,610.36	23,174.39	22.17	21.00
134	26,094.96	21,136.92	20.38	19.31
135	23,562.80	19,085.87	18.59	17.61
136	21,013.75	17,021.14	16.79	15.90
137	18,447.71	14,942.65	14.97	14.18
138	15,864.57	12,850.30	13.14	12.45
139	13,264.20	10,744.00	11.30	10.71
140	10,646.49	8,623.66	9.45	8.95
141	8,011.34	6,489.19	7.59	7.19
142	5,358.62	4,340.48	5.71	5.41
143	2,688.21	2,177.45	3.82	3.62
144	(.00)	(.00)	1.92	1.81
			------	------
Total cash received			$14,929	$14,143
			======	======

NAGGL--Net present value of SBA loan cash flow--loan not sold

Loan Amount:	$250,000	Term:	144 months
Payment amt:	2,706.13	Int rate:	8.00%

Month	Ending Principal Balance	Interest Spread (1)
0	250,000.00	
1	248,960.54	937.50
2	247,914.14	933.60
3	246,860.77	929.68
4	245,800.38	925.73
5	244,732.91	921.75
6	243,658.34	917.75
7	242,576.59	913.72
8	241,487.64	909.66
9	240,391.43	905.58
10	239,287.90	901.47
11	238,177.02	897.33
12	237,058.74	893.16
13	235,933.00	888.97
14	234,799.76	884.75
15	233,658.96	880.50
16	232,510.55	876.22
17	231,354.49	871.91
18	230,190.72	867.58
19	229,019.19	863.22
20	227,839.86	858.82
21	226,652.66	854.40
22	225,457.55	849.95
23	224,254.46	845.47
24	223,043.36	840.95
25	221,824.19	836.41
26	220,596.88	831.84
27	219,361.40	827.24
28	218,117.68	822.61
29	216,865.66	817.94
30	215,605.30	813.25
31	214,336.54	808.52
32	213,059.32	803.76
33	211,773.58	798.97
34	210,479.27	794.15
35	209,176.34	789.30
36	207,864.71	784.41
37	206,544.35	779.49
38	205,215.18	774.54
39	203,877.15	769.56
40	202,530.20	764.54
41	201,174.27	759.49
42	199,809.30	754.40
43	198,435.23	749.28
44	197,052.00	744.13
45	195,659.55	738.94
46	194,257.81	733.72

Net present value (2) of interest spread over life of loan $56,986

(1) Interest spread based on cost of funds at 3.5%.

(2) Net present value calculated based on discount rate of 8.0%, the note rate.

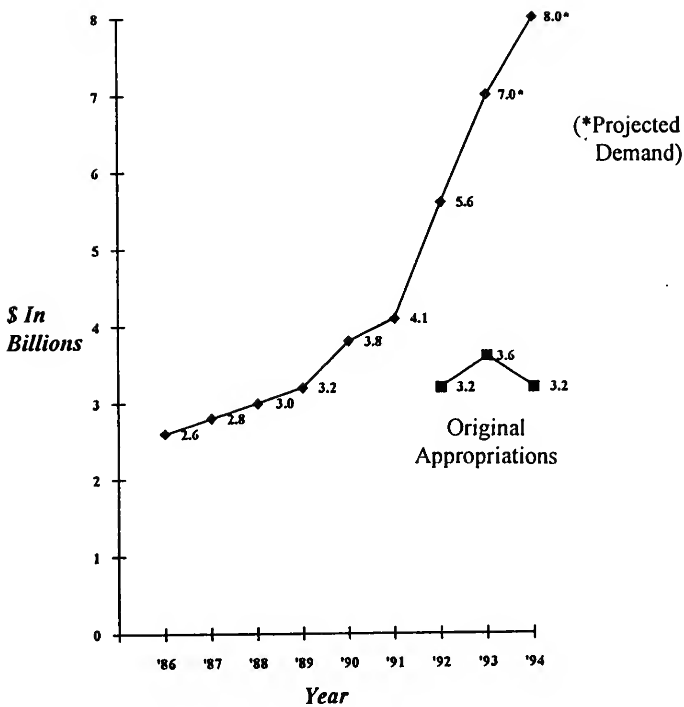
47	192,846.73	728.47
48	191,426.25	723.18
49	189,996.29	717.85
50	188,556.80	712.49
51	187,107.72	707.09
52	185,648.97	701.65
53	184,180.50	696.18
54	182,702.24	690.68
55	181,214.12	685.13
56	179,716.08	679.55
57	178,208.06	673.94
58	176,689.98	668.28
59	175,161.78	662.59
60	173,623.39	656.86
61	172,074.75	651.09
62	170,515.79	645.28
63	168,946.43	639.43
64	167,366.60	633.55
65	165,776.25	627.62
66	164,175.29	621.66
67	162,563.66	615.66
68	160,941.29	609.61
69	159,308.10	603.53
70	157,664.02	597.41
71	156,008.99	591.24
72	154,342.91	585.03
73	152,665.74	578.79
74	150,977.38	572.50
75	149,277.76	566.17
76	147,566.81	559.79
77	145,844.46	553.38
78	144,110.63	546.92
79	142,365.23	540.41
80	140,608.20	533.87
81	138,839.46	527.28
82	137,058.92	520.65
83	135,266.52	513.97
84	133,462.16	507.25
85	131,645.78	500.48
86	129,817.29	493.67
87	127,976.60	486.81
88	126,123.65	479.91
89	124,258.34	472.96
90	122,380.60	465.97
91	120,490.34	458.93
92	118,587.48	451.84
93	116,671.93	444.70
94	114,743.61	437.52
95	112,802.44	430.29
96	110,848.32	423.01
97	108,881.18	415.68
98	106,900.92	408.30
99	104,907.46	400.88
100	102,900.71	393.40
101	100,880.59	385.88
102	98,846.99	378.30

103	96,799.84	370.68
104	94,739.04	363.00
105	92,664.51	355.27
106	90,576.14	347.49
107	88,473.85	339.66
108	86,357.54	331.78
109	84,227.13	323.84
110	82,082.51	315.85
111	79,923.59	307.81
112	77,750.29	299.71
113	75,562.49	291.56
114	73,360.11	283.36
115	71,143.04	275.10
116	68,911.20	266.79
117	66,664.48	258.42
118	64,402.78	249.99
119	62,126.00	241.51
120	59,834.04	232.97
121	57,526.80	224.38
122	55,204.18	215.73
123	52,866.08	207.02
124	50,512.39	198.25
125	48,143.00	189.42
126	45,757.83	180.54
127	43,356.75	171.59
128	40,939.66	162.59
129	38,506.46	153.52
130	36,057.04	144.40
131	33,591.29	135.21
132	31,109.10	125.97
133	28,610.36	116.66
134	26,094.96	107.29
135	23,562.80	97.86
136	21,013.75	88.36
137	18,447.71	78.80
138	15,864.57	69.18
139	13,264.20	59.49
140	10,646.49	49.74
141	8,011.34	39.92
142	5,358.62	30.04
143	2,688.21	20.09
144	(.00)	10.08

Total cash received		$78,572
		======

The National Association of
Government Guaranteed
Lenders, Inc.

SBA 7(a) Loan Volume



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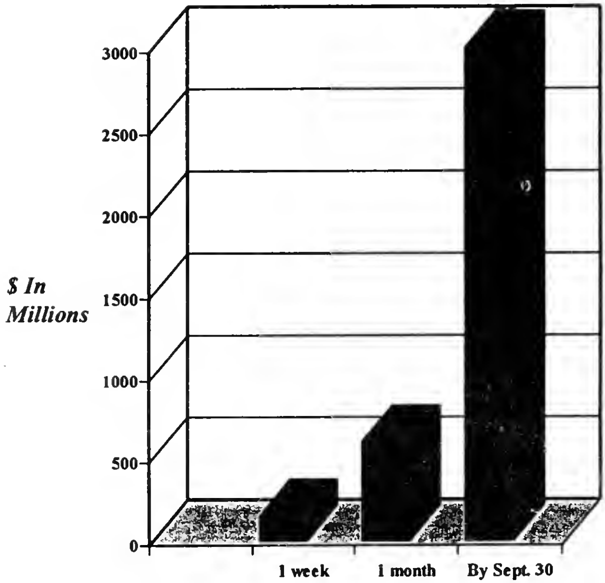
NAGGL

The National Association of
Government Guaranteed
Lenders, Inc.

Loan Applications Stacking Up

($30 million/day)



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ECONOMIC IMPACT OF SUPPLEMENTAL ON SMALL BUSINESS

We project the impact of the supplemental appropriation based upon data from a two year study of the 7(a) Guaranteed Loan Program completed last year by Price Waterhouse. The impact of a business loan takes several years to be realized. Construction may be required, workers must be hired, and it takes time for increased production to show up as increased profit to the firm. The Price Waterhouse data permit a four year projection to be made.

We project that a $2.6 billion supplemental will have the following economic impact by 1997:[1]

- **110,000 NEW JOBS**
- **A PAYROLL INCREASE OF $1.3 BILLION PER YEAR**
- **AN INCREASE IN FEDERAL, STATE AND LOCAL TAXES OF $459 MILLION PER YEAR**
- **INCREASED PROFITS OF $788 MILLION PER YEAR**

We estimate the first year employment impact to be 28,000 net new jobs.

Price Waterhouse found that 23% of the employees at businesses with SBA loans come from groups that typically have difficulty finding employment.

The cost in actual outlays from the Federal government for loan losses and SBA salaries and expenses is $2,273 per job.

It should be noted, however, that the study also measured the net impact of these loans on the public treasury. Regardless of how fast the businesses grow, how much of a burden are they upon the taxpayer? We were able to compare the program cost with the additional Federal, state and local taxes paid as a result of the loans. Costs include net costs of loan making and servicing, indirect expenses, the cost of credit risk, and the net cost of honoring SBA's guaranty on defaulted loans. Taxes paid by loan recipients have been adjusted to reflect only that portion of the firms' financing that was provided by the SBA loan. SBA estimates that the cumulative return on the government's investment in loan guarantees reached 264% within four years.

---

[1] These figures have been adjusted downward to reflect (1) the percentage of loan recipients that will not still be in business in 1997 and (2) the percentage of businesses that could have gotten equivalent financing without the SBA guaranty. These figures are for the direct impact on loan recipients and do not include multiplier effects.

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MAY 6 1993

Bacon's

Save The Small Business Administration

When President Bill Clinton's stimulus bill died, one effort that suffered was the Small Business Administration's loan-guarantee program. Under it, the SBA guarantees 90 percent of the money lent to small companies that can't get financing elsewhere. Now, the SBA is about to run out of money and to suspend the program. This result flies in the face of what both the president and Republicans want.

Small businesses create the majority of new jobs in the economy. But they can't do it without capital, much of which they must borrow. The SBA loan-guarantee program has been essential to the growth of many of them. The government pledges to repay up to $750,000 of any loan made. That guarantee also permits private lenders to accept long repayment periods, crucial to small businesses' ability to manage a loan of any kind.

Last year, the SBA saw a 37 percent increase in loan demand. Yet the administration, to save money, plans to cut financing for loan guarantees by 12.5 percent next year. This move makes no sense. Replenishing and holding constant the existing SBA fund this year is estimated to be worth 12,000 jobs alone. Cutting the program would slow future job creation. It's penny wise and pound foolish.

Many in Congress, as well as the White House, want to find a way to give the SBA at least the money it needs to keep operating. A supplemental appropriation is a possibility, but many Republicans are still insisting that other spending be cut to make up for it. This demand also was the response to the Bush administration's attempt to fund the program, but Congress couldn't find something else to cut. Finally, George Bush wisely accepted an emergency bill raising the federal deficit.

That's what President Clinton should again propose, and what this time Congress — the GOP in particular — should support to restore the SBA.

United States Senate

COMMITTEE ON SMALL BUSINESS

WASHINGTON, DC 20510-6350

July 9, 1992

The Honorable George Bush
President of the United States
The White House
1600 Pennsylvania Avenue, N.W.,
Washington, D.C. 20500

Dear Mr President:

We, the undersigned Republican Senators, are writing to express our strong support for the Small Business Administration's 7(a) loan program. The SBA 7(a) program is an example of the public and private sectors coming together successfully to promote small business development and job creation with a minimum of government intervention.

Small business entrepreneurs have led the way in creating new job opportunities, particularly for women, minorities, and young people. Two out of every three new jobs in the past decade have been created by small business; and small business ownership has provided the best opportunity for all Americans to climb the economic ladder.

The SBA 7(a) program is an important source of long-term financing for the nation's small business sector which simply is not available through conventional sources. Small businesses, which represent America's entrepreneurial spirit and carry a higher degree of risk, continue to have trouble obtaining investment capital and credit. However, recent studies conclude that SBA borrowers have higher sales, create more jobs, pay more taxes and have greater after-tax profits than small businesses that have not utilized the SBA program.

The SBA 7(a) program is one of the greatest success stories of the past twelve years. In 1980 the program was experiencing high default rates, but through hard work and proper management SBA's problem loans in 1989 were one-seventh of what they were in 1980. The 7(a) program is now operating soundly. Independent studies estimate that the government's actual rate of return on the 7(a) program may be as high as 264% – the program quickly generates far more in additional taxes that it costs.

We agree with the Administration's focus on creating economic growth and jobs by concentrating on small business, and appreciate your commitment to these goals. This is a positive direction for our nation and for the Republican party.

Best regards,

Robert W. Kasten, Jr.

Connie Mack

The Honorable George Bush
July 9, 1992
Page 2

Robert Dole

Dan Coats

John McCain

Mark O. Hatfield

Alfonse M. D'Amato

John Seymour

Christopher S. Bond

Richard G. Lugar

Bob Packwood

Bob Smith

Steve D. Symms

Arlen Specter

(ltr to Pres. SBA § 7(a) program)

Mitch McConnell

Larry Pressler

Don Nickles

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MAY 5 1993

Loan lifeline cut off

Small firms left without vital credit

By ANTHONY FAIOLA
Herald Business Writer

Since the U.S. Small Business Administration ran out of money for loan guarantees last week, Vincent Cona has gotten little sleep.

"I toss and turn at night; it's all I can think about," said Cona, who's waiting for a $25,000 federal loan guarantee to finish his Speedee Oil Change & Tune-Up franchise in Davie. "I can't open until I get that money. I've got my life savings wrapped up in this business. Without that money soon, I'm going to go bankrupt before I even open."

On April 27, the SBA ran out of funds for its primary guaranteed loan program, a financial lifeline for many small businesses caught in the credit crunch. The agency was counting on funds from President Clinton's economic stimulus package to carry it until October, when new money for the 1994 fiscal year kicks in.

But when Clinton's plan stalled in the Senate, it left the agency's 7(a) loan program — which makes up 90 percent of its credit packages — broke.

"Since we ran out of money, applications have been backlogging at a rate of about 100 per day," said Mike Stamler, an SBA spokesman in Washington. "I wish I could be optimistic about a return of the program soon. But right now, we just don't know how long it will be."

The program works this way: The SBA acts as guarantors for up to 90 percent of a loan, for a maximum of $750,000. The money itself is lent from local banks, which agree to the loans only after the SBA approves the guarantees. Borrowers usually have long terms, with interest at going-mar-

PLEASE SEE **LOAN, 3C**

CARL JUSTE / Miami Herald Staff

CAN'T OPEN: Vincent Cona says his Speedee Oil Change franchise in Davie can't open for business until he gets a $25,000 federal loan guarantee.

Politics cuts off a credit lifeline

LOAN, *FROM* 1C

ket rates.

Still, the SBA hasn't shut its doors completely. It's still issuing a handful of direct loans and loan guarantees for businesses in high unemployment districts.

But for the vast majority of customers, there's a drought, and it's unclear how long it will last. Optimists say it might be only a few weeks before Congress allocates money. The SBA, meanwhile, still will evaluate applications, granting letters promising guarantees to those who qualify. Banks will weigh those letters on a case-by-case basis, and possibly grant portions of loans before the guarantees actually come through. But in a worst-case scenario, businesses would wait until Oct. 1 for their money.

And for some, the waiting could be deadly.

"I went from bank to bank to bank; the SBA was my last hope," said Bill Pasawicz, who runs a BP Oil gas station in Coral Gables. He needs a $1 million loan by the end of the month to buy his station from BP (formerly British Petroleum), which is pulling out of South Florida.

"Frankly, at this point, I'm feeling very insecure," he said.

In South Florida, the loans have grown in popularity. From Oct. 1 to April 30, the SBA's regional office in Coral Gables approved 328 loan guarantees for $85 million. For the same period last year, 175 loans were approved for $40 million. The SBA's regional office handles 24 counties in Florida, including Dade, Broward and Palm Beach, said Charles Anderson, SBA regional director.

On Tuesday, the regional office had a backlog of 57 applications approved, but with no money to guarantee loans.

The evaluations will last at least until Tuesday, when it might decide to shelve them temporarily. For now, approved businesses are simply getting letters saying they will be eligible for guarantees.

But those letters are no guarantee that banks will lend money.

"The amount we offer in the interim will be based on financial risk," said Peter McDougal, SunBank/Miami vice president of government guaranteed lending.

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Wednesday April 28 1993
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AN EDITION OF THE LOS ANGELES TIMES

SBA's Loan Shortfall Is Big Setback for Small Business

By JUBE SHIVER JR.
TIMES STAFF WRITER

WASHINGTON—Small businesses already reeling from the credit crunch suffered a big setback Tuesday as the Small Business Administration's key loan program ran out of money and may not get any more for five months.

SBA's funding shortfall could mean that thousands of financially strapped entrepreneurs—including many in the Los Angeles area whose businesses were damaged in last year's riots—won't be able to get government-guaranteed loans until Oct. 1, the beginning of the new federal fiscal year. SBA-backed financing has been virtually the only source of long-term financing for many small businesses in recent years.

But not all the news was bad for small business. The Securities and Exchange Commission on Tuesday decided to make it easier for small firms to raise money in the stock market. The SEC decision to ease the regulatory burden on public stock offerings of less than $10 million will make it less costly for small companies to issue stock.

Both developments underscored the difficulties small businesses face in raising capital amid a nationwide credit crunch brought on in part by stricter banking regulations. The lending environment could grow even more chilly next month when new accounting rules are expected to be adopted that will force banks and thrifts to set aside more money for projected losses on bad loans, limiting further their ability to finance small and medium-sized businesses.

The credit crunch has already touched off an avalanche of guar-

Please see LOANS, A6

LOANS: Setback

Continued from A1

anteed-loan requests at the SBA that has depleted the agency's underwriting capacity. Demand for SBA-backed loans reached a record $5.6 billion during the 1992 fiscal year, an increase of more than 35% over fiscal 1991. About 22,400 entrepreneurs sought SBA loan guarantees, each of which costs taxpayers about a nickel per dollar of loan amount.

However, last week Congress declined to approve President Clinton's economic stimulus package, which contained $141 million in funding that would have provided about $2.5 billion in new small business loans.

Congress, small business groups and Administration officials are trying to complete a proposal to keep the program afloat. But with Republicans arguing that more SBA funding will worsen the deficit, it's unclear whether a compromise can be reached.

"It is incomprehensible to me that our government can just turn its back on American small business," said Anthony Wilkinson, president of the National Assn. of Government Guaranteed Lenders, a nonprofit group of banks and institutions active in SBA lending programs. "The small business community is going to find it extremely difficult to get the capital they need to continue creating jobs and generating tax revenue."

In past years, the SBA sometimes ran out of money with a few days left in the fiscal year, but the shortfall had no noticeable effect on borrowers.

This time, said SBA spokesman Michael Stamler, the SBA will be out of the guaranteed-loan business as of 10 a.m. today.

He added that the SBA's Glendale and San Francisco offices were the agency's two busiest and that a prolonged suspension of lending activity "would have the greatest impact there in California."

A congressional contingent led by House Speaker Thomas S. Foley (D-Wash.) and Majority Leader Richard A. Gephardt (D-Mo.) was scheduled on Tuesday to make an eleventh-hour appeal to President Clinton to press Congress on the issue. But there was no word from the White House late Tuesday on the outcome of the meeting.

The news was more upbeat for small companies hoping to raise money in the stock market.

The new SEC rules would expand pre-existing regulations aimed at saving small companies time and expense by letting them test whether their securities would be attractive to investors before filing formal documents.

Normally, companies offering stock must issue a detailed legal document called a prospectus that outlines the potential finanicial risk and benefits for investors.

The New York Times

MONDAY, APRIL 26, 1993

Loan Fund In Danger At S.B.A

Money Runs Low As Bill Is Blocked

By JOHN H. CUSHMAN Jr.

Special to The New York Times

WASHINGTON, April 25 — The Small Business Administration's popular loan-guarantee program will run out of money this week, a victim of the Clinton Administration's inability to push its economic stimulus package through Congress.

Demand from small businesses for the guaranteed loans has been growing much faster than the budget for the program, and beginning on Tuesday the agency will stop approving the loans until Congress acts to increase the budget, an agency official said Friday.

Under the program, businesses borrow from banks or other financial institutions, not from the Government, which guarantees 90 percent of the loans. Without those guarantees, many small businesses cannot borrow on affordable terms. The commercial lenders said they were hoping that Congress would restore the money.

"We just don't know," said Anthony R. Wilkinson, president of the National Association of Government Guaranteed Lenders. "The jobs bill was the vehicle for the S.B.A. to get its supplemental appropriation, and as of this moment in time I'm not aware that any other vehicle is moving through Congress."

A Pledge of Repayment

The Government guarantee pledges repayment of up to $750,000, and the loans are commonly made at close to market rates. But the program also provides other favorable terms, like long repayment periods, that are often not available to small businesses.

Some lenders said they would continue to take applications, but not for long.

"In two weeks, if there does not seem to be a prognosis for a supplemental appropriation, the industry is going to shut down," said Bailey Barnard, president of the Heller First Capital Corporation of San Francisco, the small-business lending subsidiary of Heller Financial Inc.

"It's just mind boggling that Congress and the Administration would let this happen," he said.

Members of Congress, including Republican Senators who acted to block the stimulus package, said they believed that the small-business loans were valuable and that a way would be found to restore them for the balance of this year.

"I am urging that Congress act on that separately, and to pay for it as we go," said Senator Larry Pressler, Republican of South Dakota and a member of the Small Business Com-

Continued on Page C9

Loan Plan In Danger At S.B.A.

Continued From First Business Page

mittee.

Unlike the S.B.A. loan provision in the stimulus bill, which would have been paid for with borrowed money, budget rules require that any separate appropriations bill be offset by tax increases or spending cuts in other programs. That would make a separate bill more difficult to enact.

Under the program, the S.B.A. must put a small amount of money into reserve for each loan it guarantees. It has written so many deals since the fiscal year began in October that it has now used up practically all of this year's money and will have to stop approving loans. It would take $141 million of additional appropriations to support an additional $2.5 billion in loans over the $3.6 billion in the budget, the agency says, bringing total lending up to $6.2 billion for the year.

When the loan program was in danger of running out of money last year, the Bush Administration initially proposed financing additional guaranteed loans by cutting other programs. After the proposed cuts proved politically unpalatable to Congress, the Administration acquiesced to an emergency bill that increased the Federal deficit.

This year, however, Republican Senators steadfastly refused to give the same emergency status to the Clinton stimulus package, of which the S.B.A. program was a relatively small part.

On Friday, Ed Yingling, the top lobbyist for the American Bankers Association, said the group would step up its lobbying for the guarantee

> Budget rules make a separate appropriations bill difficult to enact.

program and other measures intended to spur lending to small businesses.

"Everyone talks about helping small business, and this really does go in the opposite direction at this point," he said.

Cutbacks for Next Year

Lenders noted that the Administration was planning to scale back the guarantees next year to save money and they said that would result in many small businesses being unable to qualify.

The Administration's budget would cut financing for loan guarantees by 12.5 percent. The guarantees would be cut to an average of 75 percent of the amount borrowed, from the current average of 81 percent, and when banks resell the guaranteed parts of the loans to investors, as is commonly done, an annual charge of one-half of a percentage point would be levied. That would cut the Government's costs to $155 million for the year, while allowing it to guarantee a total of $6.6 billion in loans during fiscal 1994.

Lenders said that these proposals contradict President Clinton's long-standing promises to spur growth among small businesses, which he considers the most effective job-creating strategy.

"The Bush and Reagan Administrations proposed the same thing every year, and it got voted down," said Mr. Barnard of Heller First Capital. "But then it was a Republican Administration that we knew was against the program. Now you have a Democrat saying basically the same thing. For all Clinton is talking about supporting small business, he's not."

The problems for the loan program come at a time when many banks have cut back on risky loans to small businesses in an attempt to repair their own balance sheets.

The Surge in Demand

From 1991 to 1992, the S.B.A. experienced an increase of 37 percent in loan demand. For fiscal 1992, Congress initially appropriated funds to support $4.2 billion in loans, but eventually raised the guaranteed amount to $5.6 billion. For fiscal 1993, the Bush Administration received its requested funding to support $3.6 billion in loans, in the last budget enacted before Mr. Bush was voted out of office.

Since the fiscal year began in October, however, demand for the loans has again outstripped supply. Lenders, pointing out that loan demand is usually highest in the second half of the year, contend that borrowers could use as much as $7.2 billion this year if Congress would support the program.

In December, having spent all the funds available for the first three months of the fiscal year, the agency briefly stopped approving guaranteed loans. In January, it resumed at an even faster pace, on the assumption that President Clinton would shortly win his planned expansion of the program. The Office of Management and Budget gave the agency permission to spend as quickly as it liked, reserving nothing for the last six months of the year.

The Clinton Administration has estimated that replenishing the fund would create more than 12,000 jobs by the end of 1994.

Hill Fight Puts Entrepreneurs on Hold

Battle Over SBA Loan Guarantees Dries Up Funding for Small Firms

By Michelle Singletary
Washington Post Staff Writer

Ilean Baskerville is just the kind of small entrepreneur that President Clinton and Congress say they want to encourage to get the economy moving. Hoping to expand her Vienna-based document transcription company, Baskerville persuaded Patriot National Bank of Reston to lend her $81,000 in March.

But at Patriot, the money is not forthcoming. The reason: The loan is held up because Congress has not approved funds to replenish a widely used but financially depleted loan guarantee program run by the Small Business Administration.

As a result, Baskerville can't get the money she hopes to use to create two new jobs—for a marketing representative and a typist—and to buy computer equipment. If she fails to obtain the $81,000 soon, she said she may have to close her business and look for another job.

Baskerville is one of thousands of small entrepreneurs whose loans have been delayed because of the suspension of the SBA's 7(a) program. The program ran out of money April 27 and has not received more—a casualty of the Capitol Hill battle over whether to boost government spending.

There is little opposition in Congress to the 7(a) program itself. But Senate Minority Leader Robert Dole (R-Kan.) opposes the SBA's practice of using up the program's money early each year, and then coming back to Congress for more.

In addition, funds for the 7(a) program for the rest of fiscal 1993 are part of an overall supplemental spending bill that Republicans and some Democrats are opposing. Opponents contend that extra spending is not needed right now, because the

See LOANS, A18, Col. 1

SBA Fund Shortage Leaves Entrepreneurs Frustrated

LOANS, From A1

deficit is too large and the economy is doing all right on its own without extra help from the government.

Clinton promised during his campaign to support replenishing the 7(a) program as one of a variety of measures to help small businesses, which in the last decade have generated more new jobs than big businesses have. While the SBA awaits its funds, unfilled loan applications for the program are stacking up at a rate of nearly $30 million a day, according to the National Association of Government Guaranteed Lenders Inc., or NAGGL.

"Why doesn't the president go back and fight for the money?" Baskerville, 48, asked in frustration.

Under the 7(a) program, the SBA guarantees from 75 percent to 90 percent of small business loans obtained from private lenders such as banks. That means the federal government promises to cover most of the bank's loss if the small business is unable to repay its loan, even after its collateral is sold. Companies can get guarantees for loans of as much as $750,000.

Before it ran out of money, the SBA approved, on average, 100 loans a day under the program. "That's 100 different businesses, and each had a plan that was economically feasible," SBA spokesman Mike Stamler said.

million and has another $1 million in the pipeline that need SBA guarantees.

"We are sitting here without the ability to finance the loans. This could be disastrous for some businesses," Millner said.

Although SBA has continued to accept and process applications, each day the program is not operating means a small business owner is unable to purchase equipment or real estate, hire employees or retire old debt.

A long-term shortfall in funding for the program could cause many small companies—those with a loan commitment in hand—to go out of business.

"This really puts a crimp in what we do," said Stevenson, who added that his bank has approved 10 loans worth $2 million that now need SBA backing.

Scott Webster, president of Baker-Webster Printing Co. in the District, has a letter of commitment for $900,000 from Patriot National that is contingent on his getting a loan guarantee from the SBA.

> *"It makes you lose faith in the system."*
>
> — Scott Webster, president of Baker-Webster Printing Co.

Webster finally got assistance from Patriot National, he said, after he went to more than 25 finance companies and banks trying to get a loan for his 50-year-old commercial printing business.

Webster, whose business had $5 million in sales last year and employs 35 workers, said he plans to use some of the $900,000 for working capital and the rest to pay off old loans.

"I spent the last four or five years during the recessionary years dodging the bullet and I get to the point where I have a loan and then it's like I'm dressed for the prom and somebody pulls the rug from underneath me and I land in garbage," Webster said. "It makes you lose faith in the system."

"Right now I can't grow," Webster said. "I can only remain stagnant."

Bena Baskerville has been unable to get money to expand her transcription firm.

Last week, the House Appropriations Committee approved a $1.8 billion supplemental spending bill that included additional funding for the SBA loan guarantee program. But small business owners, bankers and a lobbying group for the loan program were doubtful about the bill's chances of passing any time soon.

"We are looking at serious damage to the SBA program," NAGGL President Anthony Wilkinson said. "This is way too long to leave people [loan applicants] on the hook."

The SBA program is being deluged with requests for loan guarantees, because many small businesses are unable to get loans from banks without the federal backing. Many bankers are reluctant to lend to new businesses, or small ones with a rocky financial history, because the banks face tougher standards from bank regulators spooked by the savings and loan debacle and bank failures.

"We have to find a way to preserve the vitality of small business and to increase the capacity of small business to add to the American work force," Clinton told a group of small business leaders meeting in Washington last week. "That's why we worked as hard as we could to try to create an economic program that would benefit small business. We're trying to make it easier for small businesses to apply for and to obtain loans when they are appropriate and needed to expand and create new jobs."

In the last six months, SBA twice came close to shutting down the 7(a) program because funds ran out for the three-month period, or quarter, for which they had been allocated. Each time, the agency either waited until a new quarter began or obtained permission to use funds designated for future periods.

This time, however, the SBA has used all the $195 million that was allocated for the program for fiscal year 1993, which ends Sept. 30. The agency is looking for $181 million more to put aside to provide a kind of collateral to back a total of $3.3 billion in new loan guarantees.

The SBA's policy has been to use up its funding for the program by meeting the demand for loan guarantees as long as the money holds out, an SBA spokesman said. The program is routinely underfunded with the expectation that the agency will receive supplemental funding, said congressional staff members.

But that practice may change.

Erskine B. Bowles, the newly appointed administrator of the SBA, is proposing to cut the agency's budget for the 1994 fiscal year by 17 percent to help contain the deficit. He is asking for $155 million for the 1994 fiscal year for the 7(a) program, and has told House members that he doesn't plan to seek more if the initial appropriation is granted in full.

"I hope we are asking for enough, because my style is not to come back asking for a supplement," said Bowles, a former business owner and investment banker from Charlotte, N.C.

The SBA backed a record $6.6 billion in loans in the 1992 fiscal year, an increase of more than 35 percent over fiscal 1991. That came to 22,459 loan approvals in 1992.

To qualify for the program, a small business has to prove that its loan request was turned down by one or two banks, or get a bank to certify that it won't lend the business money without the SBA guarantee.

"Our economy makes a lot of loans risky," said Kyle S. Stevenson, a commercial loan representative at Patriot Bank. "The [federal] guarantee allows you to make more loans. It's extra protection."

In a local example, District-based Adams National Bank in fiscal year 1992 made 10 SBA-backed loans worth about $3.1 million, according to Christal Milliner, the bank's director of SBA lending.

So far this fiscal year, the bank has completed three loans for $1.7 million and has another $1 million in the pipeline that need SBA guarantees.

"We are sitting here without the ability to finance the loans. This could be disastrous for some businesses," Milliner said.

Although SBA has continued to accept and process applications, each day the program is not operating means a small business owner is unable to purchase equipment or real estate, hire employees or retire old debt.

A long-term shortfall in funding for the program could cause many small companies—those with a loan commitment in hand—to go out of business.

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Webster finally got assistance from Patriot National, he said, after he went to more than 25 finance companies and banks trying to get a loan for his 80-year-old commercial printing business.

Webster, whose business had $6 million in sales last year and employs 38 workers, said he plans to use some of the $900,000 for working capital and the rest to pay off old loans.

"I spent the last four or five years during the recessionary years dodging the bullet and I get to the point where I have a loan and then it's like I'm dressed for the prom and somebody pulls the rug from underneath me and I land in garbage," Webster said. "It makes you lose faith in the system."

"Right now I can't grow," Webster said. "I can only remain stagnant."

Similar letter sent to the following: President Clinton, OMB Director Panetta, Senators Bumpers, Mitchell, Pressler, Simpson, Cochran, Burns, Domenici, Gramm, Hatfield, Nickles

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

May 6, 1993

The Honorable Bob Dole
Senate Minority Leader
United States Senate
S-230 Capitol Building
Washington, DC 20510

Dear Senator Bob:

On behalf of the 6,000 members of the Independent Bankers Association of America (IBAA), I am writing to ask for your support in immediately finding a way to fund the Small Business Administration (SBA) 7(a) loan program for the remainder of this fiscal year. As you are aware, existing appropriated funds for this very important program have run out. We would strongly support an emergency supplemental appropriations bill or efforts to reprogram funds from other areas to fund the program for the rest of the year.

It is ironic that, now that there is widespread recognition that small businesses are the primary source for job creation, one of the most accessible and efficient sources of small business funding has been shut down. While government overregulation of the nation's banks has forced many to pull back from lending, the SBA guaranteed loan program has allowed a considerable number of banks to find new outlets for making job-creating loans. And during the "credit crunch," demand for SBA loans has skyrocketed.

The SBA loan program is both efficient and cost-effective. The funds appropriated to this program are used to leverage private sector money at a rate of nearly 20 to one. While the SBA guarantees only a portion of the loans, the loans are made and serviced by lenders in the private sector. The government gets an enviable return on this investment. It is estimated that, from the additional $186 million in supplemental appropriations required to keep this program running for the remainder of the fiscal year, $3.4 billion in small business loans will be made.

Time has proven the value of the SBA program in providing small businesses with easier access to capital, in putting more people to work, and in generating more tax revenues for the government. According to a March, 1992 Price Waterhouse survey of loan recipients, the 7(a) loan program has provided the federal government over a 250 percent return on its investment in just 5 years. Furthermore, the survey estimates that, if the requested supplemental funding of $2.6 billion is provided, 110,000 new jobs will be created for the economy over

The Honorable Bob Dole
May 6, 1993
Page Two

the next 4 years. Significantly, 80 percent of those surveyed believed that, without an SBA loan, their business plans would have been negatively affected. The survey also found that a higher percentage of SBA loan recipients tended to survive than those not receiving SBA financing.

The SBA program is important to community banks as well. In addition to fostering a general improvement in the economy, it provides bankers with a new source of dependable customers which tend to create long-term relationships. The fee income generated from the loans helps the banks' bottom line, as does the fact that many of these loans are made to minorities and can thus be credited toward meeting the banks' Community Reinvestment Act (CRA) commitment.

Finally, the SBA guaranteed lending program can also play an important role in rural revitalization efforts. Production agriculture will continue to be the centerpiece of the rural economy, but the infusion of federally-guaranteed economic development funds could help diversify the rural economy so that agricultural downturns will not be so keenly felt by communities in the future.

We strongly urge you to help provide the funds to support maintaining this highly successful and critical element in supplying credit to the nation's small businesses. We believe that a strong SBA guaranteed loan program is vital to ensuring that viable small business and rural development efforts are retained.

Sincerely,

K. Guenther

Kenneth A. Guenther
Executive Vice President

Ca Lic 290312669

Four Seasons Preschool and Day Care Center
13026 La Barr Meadows Road
Grass Valley, CA 95949

Phone 272-2712

MAY 7, 1993

Four Seasons PreSchool and Daycare Center
13026 La Barr Meadows Rd.
Grass Valley, CA. 95949

To Whom It May Concern

RE: Funding Of SBA Loans

We have recently been approved for an SBA loan. After several months of putting this loan package together, we found out that funding of SBA loans could be jeoparized.

We would appreciate everything you can possibly do to help this situation. Our daycare center, which the community so desperately needs, is depending on quick action by the government officials who can help to fund these loans. The timing of this situation could either allow us to expand to meet the growing needs of our community or close our doors forever and put several employees out of work and the children at the center will be unable to find available spaces in our already over crowded daycares.

Thank You,

Denise J. Roberts

Denise Roberts, Owner
Four Seasons Preschool

INET
CORPORATION

May 3, 1993

Senator Dianne Feinstein
112 Hart Senate Office Building
Washington, D.C. 20510

Subject: Support of the SBA Loan Guaranty Program

Dear Senator Feinstein:

Once again we are seeking your support. As a member of the small business community, I am writing to request your support in providing the supplemental appropriation necessary to continue the SBA Loan Guaranty Program.

As a company who has participated in the SBA Loan Guaranty Program, we cannot stress enough how important this program has been for the survival of INET Corporation, and many other small companies.

In these uncertain times when banks are simply not able to provide important term financing to small businesses conventionally, the SBA Loan Guaranty Program is more critical than ever. This program is the main source of term credit available for small businesses and shutting it down will hinder any recovery effort.

Thank you in advance for helping to save this important program!

Sincerely,

Herman Miller

Herman Miller
Chairman/CEO

HM:mm
4M:93-127-4

8450 Central Avenue, Newark, California 94560 USA
(510) 797-9800 Fax (510) 794-7066

Truxell & Valentino
LANDSCAPE DEVELOPMENT, INC.

3661 North Highland Avenue
Clovis, California 93612

Cont. Lic. No. 480278

May 3, 1993

Senator Barbara Boxer
U.S. Senator
3301 Kerner Bl.
San Raphael, CA 94901

Dear Senator Boxer,

As a small businessman I agree with the key Clinton campaign message, "It's the economy, stupid." We are all aware that successful small businesses are key to our economic improvement. It is also clear that small business financing is the one critical component that can unleash all the entrepreneurial benefits that can fuel a national economy. I am concerned that as of April 27, 1993 the SBA Loan Guaranty Program will have used its total appropriation for fiscal 1993 with no prospect in sight to meet the anticipated $7.2 billion demand. There is nothing more logical than funding the people who can build our economy and I am troubled that this philosophy appears to be in jeopardy.

Our company benefitted from a $200,000 SBA loan in 1991 when no other lending source would assist us. Our twenty employees and their families, all of our vendors, our local tax bases, and our families have all benefitted from that loan that was critical to our business future. This SBA Loan Guaranty Program is obviously a positive program with varied and powerful implications to me and our local economies. I urge you to work to preserve and expand it.

Sincerely,

John M. Valentino

Robert and Kay McKim
12806 Mt. Royal Lane
Fairfax, VA 22033

Senator John W. Warner
225 Russell Senate Building
Washington DC 20510

Dear Senator Warner:

Before I get to the reason for this letter I would like to introduce you to the McKim family. There is husband, Robert, wife, Kay and son, Matthew. We are a typical middle class American family with a dream of owning our own business. We are a tax paying, law abiding family with not so much as a traffic violation on our record. I serve on the Board of Directors for the local preschool and as a building director for the Chantilly Youth Association. Robert and I do all the maintenance for the Pleasant Valley Preschool and its playground. We serve in these capacities voluntarily and ask for nothing in return. As I stated, we are a typical middle American family, active in our schools and community.

For the past several years, Robert and I have been researching the possibility of opening our own business. We have spent a great deal of time, energy, and money in this pursuit. After finding an ideal location for our business and using our personal funds for securing the location, I called on almost a dozen financial institutions to secure a loan for a portion of the start-up costs. Out of all those banks, only three would even consider a start-up loan and only one was willing to take the time required to obtain a SBA loan. Senator Warner, imagine our distress that after all this time and money spent that now the Small Business Administration is out of business. As I have said, Robert and I are using our personal funds to get our dream to this point but our funds are not unlimited. We have a shop which can not be opened since we haven't enough funds to properly stock it; we need the SBA's help. Please Senator Warner, I beg your colleagues and you to restore the funding for the Small Business Administration.

I had wanted to deliver this plea in person but my duties at the school prevent me from being there. I thank you for your attention and hope this problem can be worked out.

Sincerely

Kay E. McKim

Kay E. McKim

WEST WOOD SPECIALTIES, INC.
6050 Warehouse Way
Sacramento, CA 95826

May 5, 1993

Mr. Robert Rubin
Assistant to the President
National Economic Council
The White House
1600 Pennsylvania Ave., NW
Washington, DC 20500

Re: Small Business Administration 7(a) Guaranty Loan Program

Dear Mr. Rubin:

It has come to my attention the Small Business Administration's appropriations for the loan guaranty program for all of fiscal year 1993 have been depleted. My SBA loan has been approved, but now there are no funds to guarantee the loan.

This depletion of funds is a severe blow to my company's expansion plans which now must be placed on hold. I had hoped to expand my manufacturing operations and hire additional employees. Funding of my loan would have enabled me to hire a number of employees with little or no experience...the type of unemployed workers hard to employ. As you are aware, there is tremendous interest in stimulating the economy and generating jobs for the unemployed. My expansion plans would do this as well as reduce unemployment and welfare benefits, generate tax revenues, and help restore the dignity of some of the unemployed.

The loan guaranty program is one of the most efficient uses of government money. It allows small businesses such as mine to obtain loans which are not available through private sector lenders.

I request your support in finding an immediate solution to this current funding problem so that small businesses such as mine can get on with our expansion plans.

Thank you for considering my request.

Sincerely,

Chad Buford
President

AMERICAN
INNOVATIONS INC.™

P.O. Box 671 • Buckingham, PA 18912 U.S.A. • 215-345-9579 • Fax 215-345-0188

May 10, 1993

Mr. James C. Greenwood
Congressman
515 Cannon Building
Washington, D.C. 20515

REF: Availability of Funds from the Small Business Administration

Dear Congressman Greenwood,

I am a small business owner in the Doylestown, Pennsylvania area seeking additional working capital through the Small Business Administration Loan Guarantee Program. Armed with a comprehensive business plan, a breakthrough product for the health care industry, and the potential of employing several additional personnel, I have encountered reluctance by several local banks in approving my loan. A key reason appears to be the lack of available funds in the SBA itself. Please recognize that we are critically dependent upon the availability of these funds, evidenced by the enclosed copy of said business plan. Therefore, in order to directly effect the economic growth of this region, I emplore you to support our efforts by encouraging the release of said funds by Congress -- we simply CANNOT wait until the beginning of the SBA's next fiscal year.

In the interim, it may prove helpful to request that the SBA develop a letter which, in effect, states that these funds WILL be made available to the bank in October, 1993 (at the latest). This may encourage the bank's position by minimizing the period in which they are at 100% risk. The candidate bank is:

BUCKS COUNTY BANK
2 E. Bridge Street
Morrisville, PA 19067
ATTN: Ms. Suzanne M. Hartshorne,
Assistant Vice President
(215) 736-5100

This is a serious request. If you have any questions or comments whatsoever, please do not hesitate to contact the undersigned. I look forward to hearing from you in the immediate future.

Sincerely yours,

AMERICAN INNOVATIONS INC.
Karl J. Douglass
President

Encl: *American Innovations* Business Plan & Loan Request

Creative Products Solving Daily Problems ™

CLIFFORD SHANK
AND ASSOCIATES
Consultants to Financial Institutions

April 28, 1993

Mr. Robert Rubin, Assistant to the President
National Economic Council
The White House - 1600 Pennsylvania Avenue, NW
Washington, D. C. 20500

Dear Mr. Rubin:

This week, the guaranty authority for the Small Business Administration (SBA) will be exhausted for the fiscal year ending September 30, 1993. As a bank consultant with a particular specialty in SBA lending operations, I work both with bankers and borrowers. I am acutely aware of the consequences of this development. And, as damaging as this event is for the entire country, the effect will be devastating in California.

While I recognize that you, and the Clinton Administration, are supportive of the SBA, I hope that I can provide first-hand emphasis on the impact in California. As you doubtlessly know, economic conditions are especially bad here. Experts reflecting all political viewpoints are not anticipating a near term recovery. Indeed, many expect that the California recession will worsen before it improves. One of the few bright spots is the opportunity for business development, expansion and improvement that SBA loans provide -- and we can use all the bright spots that we can get! I must add that every businessperson, employee, manufacturer, service provider or banker can share in the prosperity that an SBA borrower will enjoy, often on a nationwide basis.

Lastly, I want to stress that the SBA program benefits government, too. A recent Price Waterhouse study found that the 7(a) program provides the government with a return on investment estimated at over 250%. How many other programs can make that claim?

As you know, American business is undergoing a period of transition. One of the features of this transition is the expanded importance of small businesses. I urge you to make every effort to both fund the program for this fiscal year, but also to assist in efforts to end the program's dependence on supplemental appropriations.

Yours truly,

Clifford Shank

POST OFFICE BOX NO. 9116 • CALABASAS, CALIFORNIA 91372-9116
TELEPHONE: (818) 999-1973 • TELEFAX: (818) 999-1644

WRITTEN TESTIMONY

of

JOHN SHIVERS

CHAIRMAN, PRESIDENT & CEO
SOUTHWEST BANK
FORT WORTH, TEXAS

on behalf of

THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

regarding

"THE ADMINISTRATION'S BUDGET FOR 1994"

before the

COMMITTEE ON SMALL BUSINESS

of the

U.S. HOUSE OF REPRESENTATIVES

MAY 27, 1993

Mr. Chairman and members of the Small Business Committee, I am John Shivers, President/Chairman/CEO of the Southwest Bank in Fort Worth, Texas. I also serve as President-elect of the Independent Bankers Association of America (IBAA), the only trade association that exclusively represents the interests of our nation's community banks. I appreciate this opportunity to testify before you today on the Small Business Administration's budget request for 1994.

<u>Solving the Credit Crunch</u>

Before I begin, I would like to commend you and your committee, Mr. Chairman, for the work you have done in the area of the credit crunch. These hearings highlighted the critical connection between overly burdensome bank regulations and restricted access to credit for small business. President Clinton and Federal Reserve Chairman Greenspan also recognize the importance of alleviating the credit crunch by scaling back bank regulations. On March 10, Mr. Clinton announced a package of initiatives designed to stimulate lending, especially to small- and medium-sized businesses. The President's plan takes some important steps. It would:

- permit the strongest institutions to establish a "basket" of loans that will be evaluated solely on the basis of performance and may not be criticized by examiners for documentation;
- minimize appraisal requirements;
- modify examiners' treatment of classified loans;
- and provide for a meaningful appeals process to deal with bankers' complaints about examinations.

We believe the President's initiatives are helpful and will encourage increased small business lending, but the success of the program will depend

largely on balanced implementation by the regulators. As you know, regulatory relief is not always determined by what officials say in the nation's capitol. Regulatory relief is measured by what examiners do in our institutions. It will take time for the regulators and the banks to implement these new policies and to realize the intended goal of increased lending. We understand that Eugene Ludwig, the new Comptroller of the Currency, is personally visiting all the field offices of the OCC to insure that field examiners get the word.

The President's credit crunch initiatives are a vital first step, but they are just that -- A FIRST STEP. Earlier this month before this committee, Chairman Greenspan urged Congress to consider legislative proposals for regulatory burden reduction to be announced later this spring by the Federal Financial Institutions Examination Council (FFIEC). Clearly regulatory relief is possible without compromising safety and soundness.

SBA Funding -- FY 1993

While overregulation of banks has forced caution on the banking industry, the SBA guaranteed loan program has allowed a considerable number of banks to continue making job-creating loans. During this credit crunch, demand for SBA loans has skyrocketed, completely depleting available funds. As you know, the SBA 7(a) loan program has been paralyzed since April 27 and desperately needs the additional funding.

H.R. 2118 contains $181 million in supplemental SBA appropriations for FY 1993, which would be leveraged into $3.3 billion in available loan funds. IBAA

supports its immediate passage. It is ironic that, now that there is widespread recognition that small businesses are the primary source for job creation, one of the most accessible and efficient sources of small business funding has been shut down.

Mr. Chairman, let me give you some cold, hard facts. Liberty National Bank, an IBAA member bank recently named as the top SBA lender in Florida, has provided over $20 million in SBA loans to 70 businesses in central Florida over the past three years. This loans have resulted in the creation of hundreds of jobs. Examples include:

- $35,000 to start up a marketing company that now has 50 full-time and up to 15 part-time employees.
- $75,000 to start up a restaurant that now has 30 full-time employees and is planning a second location.
- $60,000 to start up a personnel company that led to the creation of over 100 new jobs.

The list goes on, but the point is that none of these companies could have received financing were it not for Liberty National Bank's involvement in the SBA 7(a) loan program.

Looking Ahead to FY 1994

As the demand for SBA loans continues to grow from $5.6 billion in 1992 to an estimated $7 billion in 1993, scaling back funding for the program in the FY 1994 budget would be unwise. Mr. Chairman, as you pointed out last week to SBA Administrator Erskine Bowles, completely eliminating the SBA might make a significant short term contribution to deficit reduction. However, the effects

would be devastating to our economy, and, as you said, "would fly in the face of the President's efforts to end the credit crunch."

The SBA loan program is both efficient and cost-effective. The funds appropriated to this program are used to leverage private sector money at a rate of nearly 20 to one. While SBA guarantees only a portion of the loans, the loans are made and serviced by lenders in the private sector. The government gets an enviable return on this investment.

President Clinton's budget makes two recommendations for "savings." First, the Administration proposes to reduce the federal guarantee on loans from an average of 81 percent to an average of 75 percent. This reduction is intended to shift a greater share of the risk to lenders, thereby increasing scrutiny of loans and reducing the default rate. However, the practical effect of the change in the guarantee levels would be to drive deserving credits out of the SBA system altogether. These are small loans to start up businesses that are difficult for banks to make but are critical to new jobs creation. In addition, reducing the guarantee level would lower the amount a bank could lend to a single customer.

The second Administration proposal is to charge a 50 basis point fee on the unpaid guaranteed principal balance for sales to the secondary market. This uniform fee would discourage smaller working capital loans. High volume participants in the small business secondary market would simply pass any additional fees on to borrowers. Again, this proposed "savings" would serve only to reduce lending by increasing the cost.

<u>The Value of the SBA</u>

Time has proven the value of the SBA program in providing small businesses with easier access to capital, in putting more people to work, and in generating more tax revenues for the government. According to a March, 1992, Price Waterhouse survey of loan recipients, the 7(a) loan program has provided the federal government over a 250 percent return on its investments in just 5 years. Furthermore, based on the survey, SBA estimates that $2.6 billion in supplemental funding would create 110,000 new jobs for the economy over the next 4 years. Significantly, 80 percent of those surveyed believed that, without an SBA loan, their business plans would have been negatively affected. The survey also found that a higher percentage of SBA loan recipients tended to survive than those not receiving SBA financing.

The SBA is important to community banks as well. In addition to fostering a general improvement in their local economies, it provides bankers with a new source of dependable customers, which tends to create long-term relationships. And, many of these loans are made to members of disadvantaged groups, helping banks to meet their Community Reinvestment Act (CRA) commitment. Cutbacks in the SBA guarantee level will hurt these kinds of borrowers.

I would like to make one other point regarding SBA's importance to agriculture and rural America. First, let me say that, according to the Department of Agriculture guidelines, 45 percent of IBAA's members are ag lenders. More importantly, three-quarters of our member banks are located in

rural communities of less than 10,000. What we've learned from these members is that the SBA guaranteed lending program can also play an important role in promoting the Administration's efforts to create jobs in rural America and revitalize the rural economy. Many economists now believe that agriculture alone cannot support the economy of rural America, and non-farm job opportunities will be as important as government farm programs in sustaining America's family farms. Indeed, a recent GAO study found that farming was the primary economic activity in only 22 percent of non-metropolitan counties. So business, manufacturing and entrepreneurial opportunities, and not agriculture, hold the key to the future economic survival of many rural communities.

New rural job opportunities, supported by SBA guaranteed loans, could help reverse an alarming trend that threatens to turn rural America into an economic wasteland. GAO recently reported that our nation's rural population declined from 44 percent in 1930 to only 25 percent in 1990. More importantly, rural per capita income has not kept pace with metropolitan per capita income, and the gap is widening. Not surprisingly, from 1980 through mid-1992, unemployment in rural areas exceeded that of urban areas, and in 1986, rural unemployment was almost 26 percent higher than metropolitan unemployment.

Young people will return to their rural roots if job opportunities are available. But without incentives like the SBA guaranteed loan program, the rural capital just will not be available to provide these job opportunities.

Conclusion

Mr. Chairman, we strongly urge you and your colleagues to help provide not only the supplemental funds needed for FY 1993 but also adequate funds for FY 1994. We also recommend rejecting the administration's budget proposals to lower the guarantee level and to impose a secondary market fee, both of which would severely impede the success of the SBA program. Instead, we encourage your support in maintaining the existing program as a critical element in supplying credit to the nation's small businesses. We believe that a strong SBA guaranteed loan program is vital to ensuring that viable small business prospers and rural development efforts are successful.

Mr. Chairman, thank you once again for this opportunity to testify. At the appropriate time, I would be happy to answer any questions you may have.

STATEMENT

OF

SCOTT WILFONG

SENIOR VICE PRESIDENT

FIRST NATIONAL BANK OF MARYLAND

FOR

THE AMERICAN BANKERS ASSOCIATION

ON

THE SMALL BUSINESS ADMINISTRATION'S

FISCAL YEAR 1994 BUDGET REQUEST

BEFORE THE

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

MAY 27, 1993

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Mr. Chairman and members of the Committee, I am Scott Wilfong, Senior Vice President, First National Bank of Maryland in Baltimore. I am responsible for overseeing our bank's small business lending division and I am a member of the American Bankers Association's (ABA) Small Business Executive Committee. I am here to testify on behalf of the ABA and to voice strong banking industry support for the Small Business Administration's current guaranteed lending programs.

The ABA is the national trade and professional association for America's commercial banks, from the smallest to the largest. ABA members represent about 90 percent of the industry's total assets. Approximately 94 percent of our members are community banks with assets of less than $500 million. I welcome the opportunity to present ABA's views on the Small Business Administration's Budget Request for Fiscal Year 1994. Specifically, the ABA is very concerned about the effect a reduction in the guarantee level for SBA 7(a) loans will have for the ability of marginal borrowers to receive credit.

Mr. Chairman, in recent months there has been considerable discussion within the Administration, as well as on Capitol Hill, expressing strong interest in increasing lending to small business. The ABA shares these concerns. At the same time, however, we are concerned that the focus of some well intended solutions -- including the Administration's

FY94 SBA Budget request -- may only exacerbate bankers' difficulty in lending to start-up and financially marginal small businesses.

In most regions of the country, banks are experiencing tremendous excess lending capacity and are trying to rectify the situation by growing their asset base, mostly by pursuing creditworthy small business customers. However, a two-part problem affecting small business lending does exist. First, there is the problem caused by excessive regulatory costs and restrictions on bank lending to small business. Second, there is the inability of banks to lend to marginal and start-up small business ventures with insufficient equity capital, collateral, and/or business experience to receive adequate financing.

The Clinton Administration is attempting to address the first aspect of this problem -- excessive regulatory costs and restrictions -- by administratively modifying some regulations applying to small businesses. The ABA also supports H.R. 962, the Economic Growth and Regulatory Paperwork Reduction Act of 1993, legislation which reduces the excessive paperwork burden on the banking industry and alleviate the negative regulatory environment which has made it more difficult for experienced bankers to lend to small businesses. For safety and soundness reasons, neither of these efforts can significantly address the second part of the problem mentioned above -- the inability of banks to lend to marginal and start-up small business ventures. It is for these types of small businesses (lacking the usual financial components demanded by bank

regulators) that commercial banks turn to the SBA 7(a) guaranteed loan program for assistance.

Mr. Chairman, the banking industry has been a major participant in various SBA programs for years. Approximately 10,000 banks have been involved in the SBA loan programs. A primary example is the loan guarantee program, which is authorized by Section 7(a) of the Small Business Act of 1953. This program benefits the national economy and individual communities through the jobs created and revenues produced by small businesses involved in the program.

As you are well aware, small businesses employ about 60 percent of the private work force in this country and, in recent years, have accounted for nearly all of the economy's net job growth -- with most of the new jobs being created by firms with fewer than twenty employees. Because small businesses in general have limited access to capital markets and other alternative sources of credit, they are likely to be more dependent on banks to fund their operations. The SBA loan guarantee program is an extremely important tool which enables commercial banks to assist all eligible start-up companies and expanding companies that desperately need financing but are unable to qualify for traditional bank credit.

It is important to understand why the SBA loan guarantee programs are so important to the commercial banking community. Like other businesses, banks must be

able to meet their customers' needs if they are to survive. Equally important, however, is the fact that bankers must continue to be careful to evaluate the quality of loans they make rather than to simply push money out the door. Banks must continue to lend on the basis of what can be reasonably foreseen based on cash flow projections. While there continues to be an abundance of capital available to lend today, and while banks are prepared to make all the loans creditworthy small businesses need, banks cannot forego responsible and sound lending policies. Put another way, while bankers are committed to the economic vitality of their communities, particularly small businesses, their banks must continue to operate within the parameters of safety and soundness laid out by the regulators. Consequently, one way for banks to participate effectively in sound small business projects that lack the resources and credit history to qualify for a traditional bank loan is to work with government programs such as the SBA 7(a) program.

As a result, it is not surprising that the interest throughout the lending community in the SBA guarantee programs continues to grow. Unfortunately, SBA programs face problems because of their success, and, in fact, the popular 7(a) guarantee program is in the process of being penalized for its success. When there is confidence in the agency, when the program runs relatively smoothly and when the administrative burden is reduced, then participation increases. We are facing such a situation today. As you are well aware, the demand for 7(a) loan guarantees consistently outstrips the allocation of guarantee authority that the Congress has provided for these loans. In fact, the

guarantee funds for FY93 were exhausted in late April. In this regard, the ABA appreciates the efforts of the chairman and the committee members who requested and support the $181 million in additional SBA guarantee funding included in the House Appropriations Committee's supplemental appropriations bill. This vital funding will result in an additional $3.3 billion in loans to small businesses. It is our hope that this funding will move expeditiously through the House and the Senate and be signed by the President in the very near future.

This supplemental appropriations bill would enable the Federal government would be able to mobilize a force of banks to offer otherwise unavailable loans to small businesses. For local communities, this means jobs, economic development, an increase in the tax base, and perhaps the survival of a community. Everybody wins.

This brings me to proposed program changes requested by the Small Business Administration for Fiscal Year 1994. ABA is concerned about the unforeseen effect these changes will have on small business lending, and therefore is opposed to them. More specifically, the ABA is opposed to the proposed reduction in the federal guarantee from an average of 81 percent to an average of 75 percent. In addition, the ABA is opposed to the proposal to establish an ongoing fee of one-half percent per year on the unpaid guaranteed principal balance on all secondary market sales. Taken together, these two proposals will result in fewer loans being made to those who need the funding most -- marginal and start-up small businesses. This proposal, if accepted, would

not only undermine the effectiveness of the additional funding authority for SBA programs for FY93 currently moving through Congress, it would send a mixed signal to the lending community about the types of loans being sought by the SBA for the guarantee program.

Last week, SBA Administrator Erskine Bowles made the following statement before this Committee in support of the reduced guarantee level: "This means that lenders participating in the General Business Guarantee loan program will be required to assume a greater share of the risk in making loans to small businesses. Requiring lenders to assume a greater share of the risk will increase their scrutiny of potential borrowers, thereby reducing the default rate and increasing the recovery rate on repurchased loans."[1]

If the purpose in reducing the average guarantee level from 81 percent to 75 percent is to increase the credit risk scrutiny of potential borrowers, the result presents a confusing policy and a mixed message, hindering effective participation in SBA programs by bankers and borrowers alike. Bankers currently look to the SBA to help them assist marginal small business borrowers who are not presently creditworthy but, with proper assistance, have the potential to succeed. By mandating a transfer of additional risk from SBA back to the lender, the SBA, in essence, is stating that it is looking for more creditworthy borrowers to include in its portfolio of guaranteed loans. This would

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[1]Statement of Erskine B. Bowles, Administrator, U.S. Small Business Administration, before the Committee on Small Business, U.S. House of Representatives, May 19, 1993.

suggest that the SBA is moving farther away from its original purpose of helping undercapitalized small business ventures, and, instead, is more interested in bank eligible credits, many of which are currently being funded by the banking community without a guarantee. Although some SBA guaranteed funding would still be utilized at the reduced level, those marginal small businesses -- the ones most in need of SBA funds -- would be most likely not to receive credit under this structure. It is for these types of loans that the lending community turns to the SBA for assistance in the first place.

Mr. Chairman, for basic safety and soundness reasons, increasing the amount of risk a lender must assume on a marginal small business loan could well mean that a new start-up business loan that would have been made today with the help of an SBA guarantee may not get made in the future. A commercial banker's job is to assess the credit risk of a borrower by closely examining the borrower's business, management ability, and financial needs in an effort to determine reasonable cash flow projections. The bank's methods of assessing this risk are closely examined by the regulators. Loans lacking proper collateral, adequate sources of repayment, and established business history are often classified as substandard by the regulators unless they are accompanied by sufficient government guarantees.

Reducing the guarantee level on these undercapitalized loans would increase the risk exposure to the lender. Although the reduction does not seem significant on the surface, the increased exposure to the lender could result in the unguaranteed portion of

the loans being classified. In turn, this would result in requiring banks to hold additional capital against greatly increased credit exposure. More than likely, the end result would be that these types of loans to marginal small business borrowers could significantly be curtailed.

The SBA's proposal to establish an ongoing fee of one-half percent on the unpaid guaranteed principal balance on all secondary market sales would have the same result: reduced credit availability. Adding additional costs to these transactions always affects the marginal borrower first. No matter how well intended, mandated fees are always passed onto the borrower in one form or another because they are an increased cost of doing business for lenders. As with all additional costs in a loan transaction, those least able to afford it are affected the most severely. Again, some undercapitalized borrowers who would be eligible today for SBA guarantee funding may not be able to afford it with additional costs as the result of these fees.

In the end, Mr. Chairman, the Federal government has crafted a program that works. Do not change it. The SBA loan guarantee program's return on investment in terms of creating jobs and establishing long-standing productive businesses has been more than cost effective. Ultimately, it is the government programs like the SBA that enable lenders to help the marginal borrower. The SBA has been a blessing for rural communities, for inner city entrepreneurs trying to redevelop neighborhoods, and for small businesses all over America.

In conclusion, the SBA guarantees are important to banks because the guarantees permit the industry to assist this fragile, yet important, segment of our society and still satisfying bank regulators that the safety and soundness of the financial institutions are protected. With the guarantee programs, credit is provided to small businesses that could not otherwise secure credit. For expanding businesses, bankers have used the SBA loan programs to help eligible small businesses purchase needed equipment, relocate operations, and fund working capital. In addition, the guarantees permit longer-term amortization of loan repayments, thus reducing cash flow pressure and contributing to business growth and job creation which would not happen without the guarantee programs because they regulators would not approve the long repayment period.

For these reasons, it is our hope that this Committee and the Congress will continue to fight efforts to alter the SBA programs in ways that reduce its effectiveness in aiding marginal small business borrowers. As always, this Committee's continued support for the SBA programs is certainly appreciated by the banking community. The banking community looks forward to continuing to work with this Committee and the SBA in a combined effort to assist our nation's small businesses.

I will be pleased to answer any questions.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

FISCAL YEAR 1994 BUDGET REQUEST

&

FISCAL YEAR 1993 SUPPLEMENTAL BUDGET REQUEST

Presented to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

MR. KENNETH I. LUECKENOTTE

NADCO President
&
Executive Director,
Rural Missouri, Inc.

May 27, 1993

Good morning, Mr. Chairman and members of the committee. I am Ken Lueckenotte, president of the National Association of Development Companies, and also executive director of Rural Missouri, Inc., of Jefferson City, Missouri. Mr. Chairman, it is well known that you are recognized as the father of this successful economic development program. I want to thank the Chairman and the Committee for your longstanding and generous support for the 503/504 programs over the past twelve years. I also want to thank you for this opportunity to comment on the FY 1994 budget, as well as other issues pertinent to this important economic development program.

For those who might not be so familiar with the 504 program as the Chairman, I would like to briefly describe its structure and objectives. Its sole objective is to provide growth capital to deserving and credit worthy small businesses in order to create or retain jobs in both rural and urban communities. This innovative program combines the guarantee authority of the U. S. Small Business Administration with the capital formation abilities of both commercial banks and the nation's public finance markets.

Under the program, growing and profitable small businesses borrow long term funds for investment in new commercial construction, plant expansion or equipment acquisition. A key requirement of this program is that at least one new job to be created for each $35,000 of guaranteed funds. Overall project financing sources are typically split with 50% bank lending, 40% SBA-guaranteed 10 or 20 year bonds sold to private investors, and 10% owner new equity. The maximum amount of the guaranteed 504 bond for a single project is $1 million.

To deliver the 504 program to small businesses, the SBA has authorized the certification of approximately 400 Certified Development Companies covering every urban and most rural areas in the country. Except for about ten of these companies which are for profit, CDCs are "not-for-profit" community-based corporations, economic development authorities or units of governments focusing on economic development and job creation programs.

FISCAL YEAR 1993 BUDGET

First, I'd like to address the current status and expected needs of the program for the remainder of FY 93. The authorization level for this year is $775 million for 502 and 504 combined. The appropriated funds are $40 million for 502 and $700 million for 504, for a total of $740 million. A combination of the well-publicized small business credit crunch and the shortfall in funding for the 7(a) loan guarantee program has placed substantial pressure on the 502 and 504 programs. In order to meet the critical capital needs of small businesses across the country, CDCs have worked extremely hard to package, close and service a record number of loans this year. These efforts have resulted in a record number of jobs being created or retained in small businesses who could find no other source of funding.

Based on 504 approvals for FY 93 to date and historical lending patterns, we forecast a fiscal year-end requirement of between $800 and $850 million in 504 loans. Without an increase in the program's authorization and appropriation amounts, CDCs and the SBA will face a funding crisis this fiscal year. NADCO urges the committee to increase the authorization for FY 93, as well as to support an increase in 504 program funding through reprogramming of available and appropriated SBA funds from other sources.

Mr. Chairman and members of the committee, while the recovery is well underway, it continues to be extremely weak in virtually every sector of the economy. Jobs are not being created at the pace we need to sustain the recovery. The Congress is evaluating several alternatives for expanding economic development programs to get American small businesses growing again. Expansion of the SBA's 504 program should certainly be considered as a means of aiding in this effort. The 504 program, and its predecessor 503 program, have created well over 300,000 jobs in the past few years, while carrying a loan loss record which is the envy of any commercial bank lender. This is shown by the program subsidy rate of approximately 0.5%, which is by far the best of any SBA guarantee program.

We urge the committee to act quickly to provide the badly needed authorization increase for the program, and ask the committee to support a reprogramming of existing appropriated SBA funds for the remainder of the fiscal year. These actions will enable CDCs to continue working towards the administration's and Congress' goal of economic recovery through small business job creation.

FISCAL YEAR 1994 504 BUDGET

The 504 program has shown an accelerating growth rate since inception, but in the past two years has grown at an annual rate of over 25%, due primarily to the substantial reduction in commercial bank lending to creditworthy small businesses. During the recent economic crisis which caused massive job cutbacks by Fortune 500 companies, and huge financial losses from the resulting shrinkage of business, the 504 program continued to provide capital to needy small businesses which created tens of thousands of new jobs. At the same time, the loan losses suffered by SBA from the 504 program loans (and ultimately the U. S. taxpayer) continued to go down -- resulting in a subsidy decrease from 0.54% in FY 93 to 0.51% for FY 94.

Additionally, this program has continued to attract new private capital for the small business borrower. Two years ago, in addition to the 504 loans, this program leveraged about $730 million in conventional, non-SBA guaranteed funding for 504 projects. This year, it will attract over $1.3 billion in conventional loans. This will occur during a time when commercial banks continue to be reluctant to provide small business loans, and the Congress is searching for means to bring traditional lenders back to this business sector.

At the same time the program is growing, the cost to the small business borrower is at an historic low. Over the past six and one-half years, private investors nationwide have become familiar and comfortable with the 504 debentures that we sell in the market. A large measure of this comfort comes from the quality of the program which as resulted in a very low rate of defaults and prepayments. The result has been a steady decline in the interest rate spread we pay over a comparable Treasury maturity from 150 basis points at the start of the program to 60 basis points today. This combined with our current historically low rates of about 6.5% for our twenty year issues has enabled us to provide capital hungry small businesses with inexpensive funds for rapid expansion while conserving precious cash for debt service, operating expenses and even further business growth.

Mr. Chairman, for all of these reasons, we believe it is imperative that Congress continue to expand this highly effective SBA job creation program. The administration's requested program funding is $761 million for 504. While this request is an increase from FY 93's original budget, it does not answer the current needs of the program at a critical time for the U. S. economy.

We believe that total loan authority for 504 should be at least $950 million for FY 94. The additional appropriation cost for this increase, over and above the administration's request, is only <u>$965,000</u> in 504 subsidy. Our proposal will add over <u>5,400 jobs</u> at the program's federally required job creation rate of $35,000 per job. The added cost of our recommended increase will amount to only $178 in real subsidy cost per job created. This small increase in real cost will enable the program to continue funding small business job creation loans at a rate of growth similar to that of the past two years. During this weak recovery of the economy, it is extremely important that the Small Business Administration continue to provide this major source of long term fixed rate capital, since many banks are still reluctant to include small business borrowers in their lending strategies.

We urge that the FY 94 502/504 authorization be increased from the current $825 million to $1.09 billion. These programs will add over 30,000 jobs during FY 94 for expanding small businesses throughout the country. The returns to the U. S. economy will include substantial new payroll taxes, additional business income taxes, increased local and state sales and real estate taxes, and possibly decreased unemployment and welfare costs, as businesses hire unemployed workers for these new jobs. We also request that the Congress appropriate fully the amount of subsidy to fund this loan authorization level.

503 PREPAYMENT PREMIUM

NADCO testified last year, and in previous years, that the federal government should address the issue of the onerous rates of interest paid by the small business borrowers under the old 503 program. We recognize that two previous sessions of Congress attempted to rectify this injustice, only to have earlier administrations reject their proposals.

This Congress and the new administration are currently seeking a solution to this problem through administrative means. We applaud the committee's leadership and Congress's and the administration's efforts. We strongly support the search for an equitable solution to this issue. It is in the country's interests to help our small businesses grow and prosper in order to put this long-standing economic crisis behind us. It does little good to force almost 4,000 small business borrowers to pay interest rates to the federal financing bank well above the current commercial market rates offering by bank lenders.

Although these borrowers agreed to the prepayment structure in the early to mid 80's when interest rates were at an all-time high, they are now at a competitive disadvantage within their respective industries. They have been denied the traditional opportunity to restructure their debt that other sectors of the economy such as homeowners and large corporations, have been able to utilize. A rapid solution to this critical problem will enable these small businesses to expand and add new jobs to their employment rolls.

ADMINISTRATION AGENCY INITIATIVES

The new Administrator has set forth a number of major new objectives for the Small Business Administration. We support his efforts to provide improved financial assistance to the nation's many small businesses while becoming more cost effective in the delivery of the SBA's services. We would like to comment on some of his new initiatives.

We would like to address the budget and staffing proposals by the SBA for FY 94. It is proposed that the field staff of the Financial Assistance office be decreased by fifteen full time equivalent positions. While this is not a substantial change, it reflects a decrease in FTEs of over 130 from FY 1990. This decrease has occurred during a period when the work of the field loan officers has increased markedly. During this past three years, loans originated by lenders and processed by SBA field staff have increased from 45 to 62 per employee, an increase of almost 50%. The portfolio management workload has increased from $21.5 million to $31.3 million per SBA FTE.

Our industry is also concerned about the impact of increasing workloads on the servicing staffs of district offices. The SBA is piloting a centralized servicing program now in its Fresno, CA, office in order to gain efficiencies through consolidation of similar functions. We applaud and support this effort, and endorse the extension of such changes to other SBA regions as the process is refined. However, these changes should be viewed as an opportunity to redirect field staff towards more rapid processing of incoming loan packages from lenders. A reduction of backlogs within several large SBA districts will result in improved "customer" service which the new administrator has set as a personal goal.

Another pilot program which could positively impact backlogs of loan approval is the Accredited Lender Program for Certified Development Companies. Under this program, CDCs which have proven credit underwriting and loan servicing skills may take on some of the SBA responsibilities in order to move a loan request more quickly through the system. This is similar to the highly successful 7(a) CLP and PLP programs. The pilot of this concept has worked well, and we have urged the agency to expand it to a full program option, available to more CDCs across the country. The results could be less work for SBA staff and improved loan package turnaround times for small business borrowers.

We are concerned about the administration's budget for the Financial Assistance area of the agency. It indicates a decrease from $63.4 million to $56.1 million, or 12% for FY 94. While we do not know the details of this budget proposal, we are aware that field staff of the agency already operate many of their programs in a cost efficient manner. We fear that a 12% reduction will impact both the timeliness and quality of these critical programs. Further, with growth of the programs expected to continue, such cuts in both staff and funding may create increased backlogs of work, and degrade the servicing quality of the loan portfolio. This would certainly increase the losses for the program and drive the subsidy up in future years. On both staffing and funding for field offices, we urge caution in making any cuts at a time when we see increased demand for the agency's programs.

We support the Administrator's renewed focus on the business "customer" by SBA staff, and hope that the agency will continue to aggressively expand its role in the nation's economic recovery. America's new jobs will come from small business during the next decade, and the Small Business Administration should be the agency to lead the federal government's efforts to facilitate and support this job growth. Our membership stands ready to assist the Congress and the new Administrator in our combined efforts to bring the 504 economic development program benefits to more needy small businesses across the country.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions you or the Members might have.

STATEMENT

of

DOUGLAS B. KADISON
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
HORIZON SAVINGS ASSOCIATION

on behalf of

SAVINGS & COMMUNITY BANKERS OF AMERICA

before the

COMMITTEE ON SMALL BUSINESS

HOUSE OF REPRESENTATIVES

MAY 27, 1993

Good morning, Mr. Chairman, Members of the Committee, I am Douglas B. Kadison, Chairman and Chief Executive Officer of Horizon Savings Association. Horizon is a $65 million community institution headquartered in Austin, Texas. I am appearing today on behalf of the Savings and Community Bankers of America-- our national trade association representing more than 2,000 community lending institutions. While the focus of our industry is naturally on housing, we are full-scale community lenders. At Horizon, we lend to our community to maintain and enhance its economic and social strength.

I welcome the opportunity to share with you some thoughts on our institution's involvement in the Small Business Administration section 7(a) guarantee loan program. It is a wonderful program and I am passionate about it. It can be very, very beneficial to a great number of people. Let me state at the outset how unfortunate it is that the program is currently out of funds. These badly needed monies should be restored as soon as possible. The supplemental appropriations bill, H.R. 2118, should be passed at the earliest opportunity before the adverse impact worsens. Last Friday's *Washington Post*, I understand, included a front-page story about how the lack of funding has hurt local communities. Horizon is continuing to process small business loans but because of this outage of SBA guarantees, we are unable to fund new loans. It is making our borrowers frantic with worry. While some loans can be made without SBA backing, for those loans on the cusp, or needing more extended terms, the guarantee makes the extra difference.

Horizon opened for business on May 1, 1987. In June of 1988, we began SBA lending and after our first 18 months in existence, we became a certified SBA lender. In the fall of 1991 we became a preferred SBA lender. Horizon was able to accomplish this so quickly because of the technical expertise of our people, the ability to control underwriting exposure and demonstrating to SBA our overall competence. Since we began, Horizon has made over 80 section 7(a) SBA loans.

Horizon, in fact, is the only preferred and certified bank or thrift in the Austin area. That means we are better able to serve our customers' needs faster and more efficiently. For those who might be unfamiliar with the program, certified lenders are given a three-day turnaround on their loan application by the local SBA office, assuming everything is in order. Preferred lenders may decide unilaterally on SBA participation and eligibility issues, usually though on higher quality loan credits. There are only about 156 preferred lenders nationwide.

Horizon's Small Business Lending Experience

The average size of an SBA loan made by Horizon is roughly $270,000. At least 25 percent of our SBA loans have gone to women and minorities. It may be difficult to quantify the number of jobs we have helped to create, I can tell you about some of the people whose lives

have been changed for the better because of our loans:

o In a San Antonio barrio, a husband and wife ran an ice house, which is, in effect, a corner bar. They were renters and did not own the building where their business was established. The husband died and the woman, who was in her forties and raising three children, was left running the place. She was doing this for seven years until the individual who owned the building decided to sell it. Naturally, the woman wanted to buy the building. But now who would want to lend to a minority woman who owned a bar in the barrio? She needed $50,000. Horizon looked at the deal, and saw that this woman had been regularly making rent payments on her own for the last seven years. And, to top it off, the monthly principal-interest-taxes-insurance payments would be less than her current rent payments. This looked like a loan that was going to perform, so we made it. To make a long story short, the loan performed fine until recently when the woman's mother became ill and she had cover her medical bills. The loan is currently delinquent, but is still on our books and we are working it out. We made the loan because it was the right thing to do -- in every sense -- and continue to believe that.

o A company that makes memory expansion boards for computers came to us for a working capital loan. In the first year the company had sales of $600,000, and in the second year, $1.2 million. Horizon made a SBA loan of $600,000, and in the third year the company's

sales jumped to $6 million, the fourth year $18 million, then $30 million, and so on to $60 million. That company, in fact, became an entrepreneur of the year award winner. It is a great success story. Unfortunately, they grew so fast that we were unable to grow with them, and a large commercial bank ended up taking away the business.

o One bright guy working for a venture capital company came up with the idea of developing a motion detector that could be placed in warehouses or public restrooms. It would automatically turn on the lights when someone entered and turn them off when the person had left. The device would save a lot of energy. The firm where this individual worked spent $1 million on the idea, but after they decided that the market was not deep enough, the inventor was given his patent and wished good luck. Horizon made several loans over time to the inventor. That individual, who began by operating out of his garage, had $1.5 million in sales in his fourth year and now employs 25 people.

o A small business -- a local merchant -- in a small town in Texas found itself struggling to survive after a Walmart moved nearby. The local merchant tried to redirect sales and find a niche, but in the short term found himself saddled with substantial debt. To make matters even worse, the bank that he had been dealing with went out of business. The merchant came to Horizon for a $120,000 loan to pay off all the accounts receivable, consolidate debt, and takes steps to survive. Horizon made the loan. The merchant has put every dime of his

own into the business, found a niche, and is fighting back. I don't know whether his business will survive, but they have made some progress and have a real good chance to succeed. This story is not unique.

o A single woman in her early to mid-thirties ran a dog grooming business in rented space. A building came up for sale in her neighborhood which also offered her the opportunity to put boarding kennels in the back. The rent as compared to mortgage payments was very similar, but the new building offered much larger facilities. Horizon made a loan of $125,000 to her to buy the larger space. The woman turned out to be a typical small business borrower -- she knew how to groom dogs, but she was not the world's greatest businesswoman. She had some cost overruns in buying and setting up her new property. To make matters worse, her personal finances ran into some difficulties. She ultimately filed for bankruptcy. But the woman said she was going to work things out, and we believed her. She reaffirmed her debt and the loan is now performing.

Admittedly not all our SBA loans are success stories. Texas has gone through some tough times the pa-' six to seven years, but we can proudly say that we were in the market making loans when no one else would, and the vast majority have and continue to perform as agreed.

Administration Initiatives

Horizon sells all its SBA loans into the secondary market in order to relend the money to other small businesses. The Administration's proposal to charge an ongoing fee on secondary market sales would reduce profitability of small business lending to the bank. When combined with the proposed cut in the guarantee percentage, SBA lending will be considerably less attractive. Also, because of the increased long-term risk exposure there will be a reduced number of institutions who participate in the program.

While many of the Administration's initiatives to control government spending are laudable, and we are all committed to deficit reductions, there is an overriding imperative to stimulate the economy and create jobs. The SBA loan program has been successful and should be an integral part of the Administration's proposed community development and empowerment zone initiatives. There seems little rationale to handicapping a program that could be an essential element of these new proposals. Do you want to run the risk of having these new initiatives be less successful because of the diminished capacity of a program that ought to be included?

Community Reinvestment Act

Horizon's work with minority individuals has not stopped with SBA loans. Last June, Horizon invited all of the small lenders in town to join us in forming a cooperative to pool our resources and to potentially share the risk of lending to low-income borrowers. This has given us the chance to compete with larger institutions. We started with seven institutions in our group and we are now up to eleven. Examples of the types of things that we have been able to accomplish include raising funds for and sponsoring a "Habitat for Humanity" house. The program builds housing for needy and low-income people.

Further, with our combined resources, we have been able to hold outreach seminars on an ongoing basis in minority communities. Topics have included how to balance a checking account, documents needed to apply for a business loan, how to repair a balance sheet, and the nature of SBA loans and the application process. These have taken place every two weeks over a five month period. Horizon is also looking to getting involved with the Special Olympics.

CONCLUSION

Mr. Chairman, I am an old liberal from the sixties. SBA loans feel good to make, do good in the community and can be profitable. But the program needs funding to continue. Savings and Community Bankers of America appreciates the opportunity to share our thoughts and experiences with your colleagues and you. I would be happy to answer any questions that you might have.

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Testimony of

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on

SBA's 7(a) Program

Before the

United States House of Representatives
Committee on Small Business

May 27, 1993

GOOD MORNING CHAIRMAN LAFALCE AND MEMBERS OF THE COMMITTEE. THANK YOU FOR THE OPPORTUNITY TO SPEAK TO YOU TODAY ON THE SMALL BUSINESS ADMINISTRATION'S BUDGET REQUEST FOR 1994.

MY NAME IS FRANCIS R. CARROLL. I AM THE PRESIDENT AND FOUNDER OF THE SMALL BUSINESS SERVICE BUREAU, INC. (SBSB) AND SERVE AS THE CHAIRMAN OF ITS LEGISLATIVE COUNCIL. SBSB IS A NATIONAL MEMBERSHIP ORGANIZATION REPRESENTING MORE THAN 35,000 SMALL BUSINESS MEMBER FIRMS. SBSB WAS FOUNDED -AND EXISTS- TO PROVIDE LEGISLATIVE ADVOCACY, MANAGEMENT ASSISTANCE AND GROUP BENEFITS AND SERVICES TO SMALL COMPANIES EMPLOYING FEWER THAN FIFTY (50) PEOPLE. MOST OF OUR MEMBERS IN FACT, ARE SELF-EMPLOYED, SOLE PROPRIETORSHIPS, PARTNERSHIPS AND UNINCORPORATED BUSINESSES EMPLOYING 10 OR FEWER PEOPLE. WE REPRESENT THE NATION'S TRUE "SMALL BUSINESSES".

PERSONALLY, MY CREDENTIALS INCLUDE OVER 11 YEARS OF SERVICE ON THE SMALL BUSINESS ADMINISTRATION'S NATIONAL ADVISORY COUNCIL, AS AN APPOINTEE OF PRESIDENTS FORD, CARTER AND REAGAN. I AM ALSO A FOUNDING MEMBER OF THE DEMOCRATIC NATIONAL COMMITTEE'S COUNCIL ON SMALL BUSINESS. THIS SERVICE, AND MORE THAN THIRTY YEARS OF WORKING WITH SMALL BUSINESS PEOPLE HAS MADE ME ACUTELY AWARE OF THE PROBLEMS THEY FACE, ESPECIALLY IN REGARD TO CAPITALIZATION.

IN 1953, THEN-PRESIDENT EISENHOWER CREATED THE SMALL BUSINESS ADMINISTRATION TO PROMOTE, ASSIST AND COUNSEL SMALL FIRMS AND TO

MAKE DIRECT LOANS WITH GOVERNMENT MONEY. OVER THE YEARS THE AGENCY HAS EVOLVED AND TODAY ONE OF THE MOST SUCCESSFUL PROGRAMS IT ADMINISTERS IS THE 7(A) LOAN GUARANTEE PROGRAM. THROUGHOUT THE YEARS, THE SBA AND ITS 7(A) PROGRAM HAS MEANT THE DIFFERENCE BETWEEN SUCCESS AND FAILURE FOR THOUSANDS OF SMALL BUSINESSES. CONSIDER THIS: THE SBA HAS DELIVERED MORE THAN 12 MILLION LOANS, CONTRACTS, COUNSELING SESSIONS, AND OTHER FORMS OF ASSISTANCE TO SMALL BUSINESSES. WITH A DIRECT AND GUARANTEED BUSINESS LOAN PORTFOLIO OF APPROXIMATELY $22.5 BILLION, SBA IS THE LARGEST SINGLE FINANCIAL BACKER OF SMALL BUSINESS TODAY.

UNDER THIS PROGRAM SMALL BUSINESSES ARE ABLE TO SECURE MUCH NEEDED CAPITAL FROM BANKS. NINETY PERCENT OF THOSE LOANS, UNDER $155,000 ARE GUARANTEED BY THE FEDERAL GOVERNMENT. WITHOUT THOSE GUARANTEES, MANY SMALL BUSINESSES CANNOT BORROW ON AFFORDABLE TERMS. IN ADDITION TO THE GOVERNMENT GUARANTEES, THE PROGRAM PROVIDES FAVORABLE TERMS THAT ARE OTHERWISE UNAVAILABLE TO SMALL BUSINESSES. FOR EXAMPLE, THE LOANS ARE COMMONLY MADE AT CLOSE TO MARKET RATES AND THE REPAYMENT PERIODS ARE LONGER.

THE SMALL BUSINESS SECTOR WILL BE THE FORCE WHICH BRINGS THE COUNTRY OUT OF ITS CURRENT ECONOMIC SLUMP. AS WE ALL KNOW, THE CONTRIBUTIONS OF YOUNG, SMALL FIRMS TO INNOVATION AND JOB CREATION IS FAR MORE SIGNIFICANT THAN THAT OF BIG BUSINESS. SMALL BUSINESSES PROVIDED ALL OF THE NET NEW JOBS FROM 1988-1990, WERE 99.7 PERCENT OF ALL EMPLOYERS IN 1990, EMPLOYED 65 PERCENT OF THE

PRIVATE WORK FORCE IN 1990, CREATED 40 PERCENT OF THE NATION'S NEW HIGH-TECHNOLOGY JOBS LAST YEAR AND, PROVIDED TWO OF EVERY THREE NEW WORKERS WITH THEIR FIRST JOBS.

THE ADMINISTRATION HAS PROPOSED A REDUCTION IN THE GOVERNMENT GUARANTEE PROGRAM FROM 90 PERCENT TO 70 PERCENT, AND AN IMPOSITION OF A SURCHARGE ON LENDERS IF THE LOANS ARE SOLD IN SECONDARY FINANCIAL MARKETS. MANY PRIVATE LENDERS SAY THIS WOULD FORCE THEM TO MAKE FEWER SBA-BACKED LOANS. AND, THEY ARGUE, THE PROPOSALS CONTRADICT PRESIDENT CLINTON'S CAMPAIGN PROMISE TO SPUR GROWTH AMONG SMALL BUSINESSES.

WHY IS THE ADMINISTRATION PROPOSING TO LIMIT ACCESS TO CAPITAL FOR THE SMALL BUSINESS COMMUNITY, WHICH REPRESENTS THE ONLY CURRENT POSITIVE ECONOMIC TREND? IT IS COUNTERPRODUCTIVE TO INHIBIT THE ONE SECTOR OF THE ECONOMY ENJOYING ANY REAL GROWTH.

ACCORDING TO OFFICIALS AT WORCESTER COUNTY'S FLAGSHIP BANK AND TRUST, IN THE LAST 2 MONTHS THE BANK HAS APPROVED, OR IS IN THE PROCESS OF APPROVING LOANS TO 33 COMPANIES REPRESENTING APPROXIMATELY $7 MILLION IN FINANCING AND LEADING TO THE CREATION OR RETENTION OF ALMOST 1,200 JOBS IN CENTRAL MASSACHUSETTS. THE AVERAGE SIZE OF THESE LOANS IS $130,000. THE NEW RULING WOULD PUT A NUMBER OF THOSE LOANS AT RISK.

FLAGSHIP OFFICIALS INDICATE THEY ARE STRONGLY OPPOSED TO THE IMPOSITION OF A SURCHARGE FOR SELLING TO THE SECONDARY MARKETS. BECAUSE IT DISCOURAGES LIQUIDITY, THE IMPOSITION OF THIS FEE WILL BE DEVASTATING TO THE 7(A) PROGRAM. COUPLED WITH THE GUARANTEE RATE REDUCTION, FLAGSHIP OFFICIALS FEAR THE ADMINISTRATION'S PROPOSALS WILL DETER NEW LENDERS FROM PARTICIPATING IN THE 7(A) PROGRAM AND DISCOURAGE CURRENT PARTICIPANTS FROM APPROVING ANY MARGINAL LOANS. FROM MY EXPERIENCE, I AGREE WITH THEM.

A WORCESTER BASED SMALL COMPANY WITH $6 MILLION WORTH OF PROPERTY AND A CREDIT HISTORY THAT INCLUDES SATISFYING A $1 MILLION LOAN IN SEVEN YEARS WAS RECENTLY DENIED A LOAN FOR $500,000. THIS WILL BE THE FUTURE FOR AMERICAN SMALL BUSINESSES. THEIR SURVIVAL IS THREATENED UNDER THE ADMINISTRATION'S PROPOSAL.

EVERYONE TALKS ABOUT HELPING SMALL BUSINESSES AND TAKING STEPS NECESSARY TO HELP SMALL BUSINESS CREATE THE JOBS THIS ECONOMY MUST HAVE TO MOVE FORWARD. THIS PROPOSAL MOVES IN THE OPPOSITE DIRECTION OF THAT PLEDGE.

WE TALK ABOUT THE PROLIFERATION OF CRIME IN AMERICA TODAY. TO LEAVE A SMALL BUSINESS BLOODIED BY THE ECONOMY IN THE STREETS TO DIE WITHOUT ANY LIFE SUPPORT SYSTEM IS MERCILESS AND A TRAGIC WASTE. THE FEDERAL GOVERNMENT HAS A RESPONSIBILITY TO THE MEN AND WOMEN WHO BUILT THIS COUNTRY TO STAND WITH THEM AND GROW AND NOT TO RISE UP AGAINST THEM.

IT IS MY OPINION THE WHITE HOUSE IS MISTAKEN WHEN THEY SAY THE PROPOSED CHANGES WILL HELP MORE THAN HAMPER LENDING. IT IS ESSENTIAL NOW MORE THAN EVER THE FEDERAL GOVERNMENT STAND BY THE SMALL BUSINESS COMMUNITY AND RETAIN THE CURRENT GUARANTEE RATE FOR LENDING TO SMALL BUSINESSES.

I STRONGLY RECOMMEND, MR. CHAIRMAN, YOU MAINTAIN THE CURRENT SBA GUARANTEE RATE FOR SMALL BUSINESS LOANS AND OPPOSE THE IMPOSITION OF A SURCHARGE. THANK YOU FOR THE OPPORTUNITY TO PRESENT MY VIEWS. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS.

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Statement of

Lewis A. Shattuck
Executive Vice President
Barre Granite Association

Before the
U.S. House Small Business Committee

Regarding
Budget Priorities
for the U.S. Small Business Administration

On Behalf of
National Small Business United

May 27, 1993

Mr. Chairman and Members of the Committee:

Good morning. I am Lewis A. Shattuck, and I am here representing National Small Business United at today's hearing. I am Executive Vice President of the Barre Granite Association, the former President of the Smaller Business Association of New England (SBANE), and Trustee Emeritus of National Small Business United (NSBU). I welcome the chance to be here today and to comment on the budget priorities of the Small Business Administration (SBA), a critical institution for the small business community.

First, I would like to make clear the commitment of National Small Business United to substantial deficit reduction. To this end, there are significant portions of the President's economic strategy of which we have been very supportive, though we think further budget cuts are necessary and available. But the fact remains that if all federal programs had sustained the cuts that the SBA has seen in the last 12 years, we would not be worrying about our deficit.

To be sure, the SBA has been subject to some criticism. Though the SBA has shortcomings, it is still the most effective economic development agency for the small business community and entrepreneurship that we have seen. It has also served the nation and its economy through the growth and expansion of small businesses, which the agency has fostered. An investment in the SBA is an investment in the growth of small business, an investment that will add many more dollars to the federal treasury than any narrow program cuts are likely to attain. Administrator Bowles said last week that "President Clinton is determined to do what is necessary to help small business create the jobs this economy must have to move forward again." Adequate funding of SBA's programs should be a cornerstone of any serious effort to increase employment.

Today, I would like to address several special aspects of the Administration's FY 1994 budget for the SBA.

7(a) Guaranteed Loan Program

This Committee is today faced with two fundamental questions: 1) Will this Administration succeed, albeit unintentionally, where David Stockman failed at dismantling the SBA in substantial ways; and 2) Will this Committee continue to stand up to the Administration and oppose these damaging cuts, as it has done in the past?

Mr. Chairman, what the Administration says and what it does with respect to the nearly universally recognized small business credit crunch are two different things. On the one hand, they say the right things about solving the credit crunch and have provided a modicum of small business lending relief in the form of the Interagency Policy Statement on Credit Availability. And, we are pleased that the Administration supports the efforts of Chairman Neal Smith, you Chairman LaFalce, and the many individuals on this Committee and others to fully fund the 7(a) loan program during FY 1993.

However, the Administration is doing the wrong thing by substantially curtailing support for the 7(a) loan program in FY 1994 and beyond. It is as if the Administration believes that the credit crunch will be over on October 1, 1993 and small business credit needs will have been adequately met. We know that will not be the case. President Clinton has correctly pointed to three critical and recurring themes in our economy to which we must respond: 1) the credit crunch; 2) the need to create more jobs; and 3) the general economic "malaise" that continues

to plague the country. The SBA's 7(a) Guaranteed Loan program can play an important role in alleviating all of these problems.

For FY 1994, the Administration proposes to fund the 7(a) program at approximately $155 million, less than the supplemental funding request alone for 1993, and $217 million less than the total funding for 1993--all at a time when demand for this program far outstrips the supply. I know of no other federal guaranteed loan program proposed for such a drastic reduction--not the loan programs at the Farmers Home Administration, MARAD, at EDA or anywhere else. Is this reflective of the Administration's efforts to do everything possible to solve the small business credit crunch? Again, the Administration seems to be saying one thing and doing another.

As if the FY 1994 funding request were not bad enough, the Administration also proposes to reduce the 7(a) subsidy rate, the amount that must be appropriated for every dollar of loan guarantee, from 4.92 percent to 2.35 percent. It is suggested that this will make banks improve the quality of their loans and reduce the default rate on 7(a) loans. Perhaps, but the least likely result is more credit being made available to small business.

This proposed reduction in the 7(a) subsidy rate is exactly the same sort you and the Committee consistently rejected over the last 12 years. We urge you to do so again.

My purpose is not to speak for 7(a) lenders, but we all need to recognize that those lenders do not have to make 7(a) loans. They do so for a variety of reasons. For example, they make a good return on those loans, and the loans help them meet Community Reinvestment Act requirements. If the Administration's subsidy rate proposal forces banks to improve the quality

of their loans, while reducing the income flowing from 7(a) loans, we can expect a bank to do one of two things: either the bank will stop making small, working capital loans where they get a low rate of return and only make large highly profitable loans, or the bank will stop making 7(a) loans altogether. We do not support the proposed reduction in the 7(a) subsidy rate because all it will do is force small borrowers, small loans, and small banks (who most often use the secondary market) out of the program. Therefore, the subsidy rate proposal will only exacerbate the credit crunch for many small businesses.

Perhaps more significantly, this proposal could evaporate years of SBA cultivation of relationships with banks across the country. For years, the SBA has assiduously courted banks for participation in the 7(a) program, reducing paperwork, making it more financially attractive. All of the work could be lost in one fell swoop if this proposal convinces banks that participation in the 7(a) program does not make financial sense. We urge you to consider this point very carefully.

Finally, Mr. Chairman, even if Congress accepted <u>in toto</u> the Administration's budget proposal for the 7(a) program, there would only be $6.6 billion in loan authority for 1994. That amount is less than this year's program level (assuming passage of a supplemental appropriations bill) and insufficient to meet demand. Small business does not want to ask for another supplemental appropriations bill for FY 1994. Let us solve the 7(a) problem today, and not have another program shut-down. Let us have the Administration make a commitment to the program which reflects the words they have spoken about the importance of solving the credit crunch and creating jobs, which President Clinton has made his number one priority. We urge the Committee to ask Administrator Bowles to go back to the Office of Management and Budget with the message that the 7(a) program needs and deserves more funding.

Small Business Investment Company Program

Mr. Chairman, the small business community has great difficulty in raising sufficient venture capital. Small high-risk companies are almost systematically excluded from most capital markets. Overall venture capital investment has declined dramatically in recent years, and the first investments to go were the higher risk small business investments. Yet the success and growth of these companies is vitally important to this country's future economic growth. Fortunately, the Small Business Investment Company (SBIC) program exists, as the only federal program providing this type of equity financing to the nation's small business community. The SBIC program was created by this Committee in 1958 and has consistently performed as intended.

The Small Business Investment Company (SBIC) program is initiating a new activity which raises capital through a preferred securities mechanism. This is a program that this Committee had the foresight to approve and get behind. It is critically important that this new program get off to a sound start. The future success of the SBIC program is clearly linked to this program. While the Administration's budget recommendation for the SBIC program (for a total authority of $167 million) provides a small amount of growth for the program, we are concerned that the amount may be insufficient to continue the necessary parts of the traditional debenture program of the SBICs while successfully beginning a new program, designed to revitalize the SBICs for the future. This is not the right time to be cutting corners in this part of the budget.

Small Business Development Centers

The budget recommendation for the SBA's Small Business Development Center (SBDC) program holds steady for FY 1994 at 1993 levels, with no growth for inflation. Already, the SBDCs do not advertise themselves or engage in public service announcements because they have more demand for their services than they can handle--while many small businesses do not even know about them. The SBDCs are a valuable resource which should be made more available. In order for them to meet their true potential for the small business community, they should be authorized at increased levels so that, should additional funds become available, they can be utilized by the program.

The SBDC program is very popular across the country; there is an SBDC program in every one of the 50 states. It provides services and advice that many small businesses can find nowhere else. Moreover, the SBDCs provide a model for a state-federal cooperative, and mutually supportive, program that has worked. We must continue to support its growth and innovation.

The Development Company Program

The Development Company Lending Program (Section 502/504 Program) is a very important program that has served the small business community well over the years. The members of NSBU were active in its creation and we have continued to support its continuation and growth. There are now about 327,000 U.S. jobs that would not exist without this program.

Surety Bond Program

The Surety Bond Program is an innovative and highly successful program, which puts many smaller businesses on equal competitive footing with many larger concerns. This program is particularly helpful to the types of businesses that I now represent, as well as small construction firms. Despite the very low government risk on this program and the very high rate of return--$1.6 billion in government savings and 47,000 new jobs--it is disappointing that it has not been recommended for a larger funding increase.

Procurement Assistance

The federal procurement process continues to be a thorn in the side of many small businesses. One bright spot in this process is the assistance provided by SBA's Office of Procurement Assistance. This office not only assists small businesses in the procurement process but saves the federal government substantial money by increasing small business participation in the competitive process. This office does a fine job and should continue to be a priority.

Small Business Innovative Research

Due mostly to the diligent efforts of this Committee and its Chairman, we now have a renewed and strengthened Small Business Innovative Research (SBIR) Program. The SBIR program is an enormous boon to small business research, as well as the commercialization of those efforts. NSBU is a long-time and original supporter of this effort and continue to be impressed with its results. The SBIR program should be strongly emphasized.

Office of International Trade

The Office of International Trade does a good job on a very limited budget. With the dollar low, now might be a good time to step-up these activities and further increase the small business participation in international trade. As you certainly know, the international economy will soon be truly global. Without strong participation from small businesses, the U.S. will fall increasingly behind in this battle for jobs and economic share.

Office of Advocacy

Many leaders in the small business community deem advocacy to be the SBA's most important role. The Office of Advocacy is the only consistent resource for reliable information about the status and role of small business in the American economy. The Office of Advocacy is the only government institution analyzing the impact of government actions and regulations on small business. The Office of Advocacy is the only organization soliciting and funding research into the activities and needs of small business. And all of these activities are vital to designing government policy for small business and for considering small business in the legislative process.

But for the Office of Advocacy to run effectively, it must have a strong Chief Counsel for Advocacy. We urge you to encourge the President to make such an appointment at the earliest possible occasion. And, of course, this office must be funded at levels necessary to keep up with its substantial responsibilities

White House Conference on Small Business

As the White House Conference on Small Business approaches (if it approaches!), it must be fully funded at authorized levels. Of course, the chances of holding the Conference by the legislated date in 1994 has grown distinctly dim, but that is a subject for another hearing. It is simply unfortunate that the Bush Administration took no action on the Conference until so late in the President's term. In this room in May, 1990 a hearing was held to create a new White House Conference on Small Business. Thanks to the efforts of this Committee, the third White House Conference on Small Business shows considerable promise to mobilize small business activists in all fifty states. This Committee should do all that it can to keep that hope alive. National Small Business United is ready to do whatever is necessary to make the next Conference the best ever.

I want to thank you for the opportunity to be here and speak about this nation's most critical programs for the development of entrepreneurs and the small business community.

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Testimony by

JoAnn H. Price, President
National Association of Investment Companies

before the
House Small Business Committee

May 27, 1993

Good morning, Mr. Chairman and members of the House Small Business Committee. I am JoAnn Price, President of the National Association of Investment Companies (NAIC). NAIC is the trade association representing the minority venture capital industry.

I am pleased to have the opportunity to appear before the House Small Business Committee to speak on behalf of the Specialized Small Business Investment Company Industry and to share with you the positive track record we have established over the years.

Over the past ten years, we have invested over $1 billion in approximately 12,600 minority-owned small businesses. As this Committee is aware, this was accomplished even through sustained periods of instability in both the private and public sectors.

That is why we are particularly pleased to appear before you today--for the first time in many years--to express optimism regarding the future of this program's public/private partnership.

This program has not used its full program funding levels during the past few years for a myriad of reasons which I will not go into today. I do, however, want to make the point that we fully expect a significant increase in leverage demand during fiscal year 1994. This increase in demand will occur for a number of reasons, including:

<u>The implementation of the Small Business Equity Enhancement Act.</u> The Small Business Equity Enhancement Act, spearheaded by this Committee, includes several provisions which will help draw more new capital into the industry, perhaps most significant of which is the provision which recognizes certain state and local funds as private capital. NAIC has received so much outside interest as a result of this provision that we have formed a special marketing committee to meet with state and local officials to discuss the program.

<u>Implementation of the preferred stock repurchase program.</u> The SBA

is implementing a program, discussed in more detail later in my statement, which will allow existing companies to restructure their balance sheets to enhance their ability to attract additional capital.

Potential passage of minority business tax incentives. As I will discuss later in my statement, we have made significant progress toward the passage of tax legislation which would provide important incentives to invest in the Specialized SBIC industry.

Private marketing initiatives. As many members of this Committee are already aware, NAIC has been involved over the past few years in an important initiative which would raise significant pools of capital for the minority venture capital industry by creating a large fund of funds. The fund of funds will act as an intermediary to raise capital from sources who have not in the past engaged in a significant level of minority venture capital investments. The fund would then place its investment capital with a number of qualified experienced minority venture capital firms.

The new Administration has voiced its strong support of minority

capital formation. And the Small Business Administration is playing an instrumental role in many of the capital formation initiatives I have just mentioned as factors which will significantly increase this industry's demand for leverage. However, the Small Business Administration has proposed to leave our program's funding levels in both direct and guaranteed funds at essentially the same levels they were at in the fiscal year 1993 budget.

Although we are cognizant of the Agency's funding constraints, we believe it is important that as the Administration commits itself to these capital formation programs, it realizes that they will produce the need for increased funding. We are concerned that this has not incorporated into the Administration's budget proposal, although we have received indications that our industry would have access to the regular SBIC guarantee authority should it be needed.

NAIC is encouraged by the new Administration and its focus on small business development, particularly in the area of minority business development. We also view the appointment of Erskin Bowles as the new SBA Administrator as encouraging. Mr. Bowles has a background in the

finance industry, and we believe this is very important in providing the kind of expertise required to be an effective Administrator.

Within the Agency itself, we are pleased to report that after a number of years we are moving forward with the SBA to implement a very important initiative spearheaded by this Committee--the preferred stock repurchase program. This program will allow our companies to restructure to recapitalize. Two companies have already completed the transaction with the Agency, and four other companies are working to complete the program on a pilot basis before it becomes available to the entire industry, hopefully some time this fall.

The preferred stock repurchase program is just one of many programs we are working on to direct capital more efficiently into the minority venture capital community. Another recent example is a package of tax incentives we were able to have included in the House tax proposal. We owe some measure of our success in this endeavor to members of this Committee.

Last year, Mr. Chairman, you supported this industry by introducing important tax legislation which would have attracted more capital into the

minority venture capital industry. As you will remember, we made significant progress last year. Building on that progress, similar legislation was introduced this year by Committee member Congressman Mfume. Although we were unable to get the exact provisions of either of those bills incorporated into the House tax bill, clearly the work done on those two measures helped to lay the groundwork for the incentives which were ultimately accepted.

The House tax package includes two important incentives for minority capital formation. First, it contains a provision which would allow investments in Specialized Small Business Investment Companies to qualify for a 50% exclusion on capital gains. Second, gains from other investments which are reinvested in a Specialized SBIC can qualify for a tax deferral. Individuals are allowed to defer up to $50,000 a year in gains with a lifetime cap of $250,000 while corporations are allowed to defer up to $250,000 a year with a $1 million lifetime cap.

These two provisions are very important to our capital formation initiatives, and we hope this Committee will continue to support their

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inclusion in the final tax package which is sent to the White House.

NAIC views the tax incentives as a significant first step toward increasing the flow of capital to a very important sector of our economy. After years of development and growth, the minority venture capital industry is finally being recognized for its contribution not only to the minority business community, but to the American economy.

In demonstrating this point, I would like to bring to this Committee's attention a recent book by Dr. Timothy Bates which was published by the Joint Center for Political Studies, Banking on Black Enterprise. Dr. Bates' research suggests that the most direct approach to increasing minority employment is to invest in minority owned firms. When he reviewed firms located in 28 large metropolitan areas, he discovered 89% of the black-owned firms had workforces consisting of at least 75% minorities. In comparison, 60% of the non-minority owned businesses hired no minorities whatsoever.

Approaching the subject from another angle, Bates researched the same 28 large metropolitan areas and studied them by minority vs. non-

minority neighborhoods. He found that, even in minority communities, non-minority-owned firms hired predominantly non-minorities. Alternately, black-owned firms located in non-minority neighborhoods still tended to hire minorities.

Clearly, the positive impact of investing in minority-owned firms goes far beyond the dollar amount of that initial investment to the strengthening of the very infrastructure of the minority community.

The next decade is crucial to the development of the minority venture capital industry. We have proven that we can successfully invest in specialized markets and make a return on investment. We have assisted in creating wealth and witnessed the positive impact many of these companies have had on individual communities. We have developed the venture capital talent, the national network, the deal flow, and the institutional and entrepreneurial relationships. Our future need is to continue to convince institutional investors and pension funds that investing in minority venture capital is an essential part of the minority economic development strategy. The ability to attract this capital is critically dependent upon a stable and

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reliable public/private partnership. The responsibility for creating and maintaining a balanced environment must be shared by the government and private sector, both of whom have invested resources, talent and time.

Mr. Chairman and members of the Committee, your leadership and support for the Specialized SBIC program is greatly appreciated. Thank you once again for this opportunity to testify.

N A S B I C

Statement

of

James A. Parsons

National Association
of
Small Business Investment Companies

before the

Committee on Small Business

U.S. House of Representatives

May 27, 1993

NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES
1199 N. Fairfax Street • Suite 200 • Alexandria, VA 22314 • Tel: (703) 683-1601 • FAX: (703) 683-1605

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to testify today on the Administration's proposed 1994 fiscal year budget for the Small Business Administration.

I am testifying today in my capacity as Chairman of the National Association of Small Business Investment Companies (NASBIC), which is the national trade association for the SBIC industry.

In my real life, I am a General Partner of RFE Investment Partners, a venture capital firm located in New Canaan, CT. RFE manages several venture funds, including an SBIC with $10 million of private capital which was licensed in 1980.

My testimony will focus exclusively on the SBIC program, and our views of the funding needed in 1994 to revitalize this important, low cost, job creating program.

Small Businesses Need Growth Capital

This Committee knows as well as we do that small growth firms are the primary engine of job creation in the U.S. economy. In normal business cycles, small business creates 65% of all the new jobs created in the economy. And recently, the job creation record of small business has been extraordinary. Between 1987 and 1992, small growth firms created 5.8 million net new jobs, while big business lost over 2.3 million jobs. In short, small business created all of the net new jobs in the economy during the last six years.

But, we also know that in today's market, many small businesses are having a very difficult time securing access to the credit. This Committee's efforts have given very high visibility to the small business "credit crunch," and the Administration's efforts to provide relief through bank regulatory changes is a good first step to solving this problem.

What is less understood, however, is the severe problem small growth firms now face in obtaining the patient, long-term capital they need for growth and expansion.

Over the past six years, the sources of venture capital for small, emerging companies have literally dried up before our eyes. Here's what has happened to the three major sources of venture capital for small business:

- The level of institutional investments in venture funds has dropped sharply in recent years. In 1984 investments in venture funds totaled $3.2 billion. By 1991 that investment level had dropped to $1.3 billion. The net result is a sharp drop in the total amount of venture dollars available for investment in small growth firms. At the same time, this problem has been further exacerbated by a severe contraction in the venture industry, and a shift to venture mega funds that invest primarily in larger companies and leveraged buyouts.

- The SBIC industry has suffered through a period of severe contraction. In 1985, there were 450 operating SBICs. Today, there are only 200, and the rate of SBIC investments in small firms has suffered a proportionate reduction.

- With the elimination of the capital gains tax differential, many so-called "angels' have withdrawn from venture investments in small firms, choosing instead to put their funds in more secure investment areas.

The net result is a severe shortage of long-term patient capital that new start-up companies and small emerging businesses need to grow and survive.

Can SBICs Help Solve the Problem?

A revitalized SBIC program can be a major force in solving this problem.

SBICs intentionally use an investment strategy that targets their investments in small firms that have high rates of growth, and this usually coincides with high rates of job creation. Consequently, and despite severe problems over the last several years, the SBIC industry has a very successful track record in assisting small growth firms that create jobs and generate new tax revenues.

SBICs have invested $9.1 billion in over 83,000 small business concerns since 1958, and these investments have created an outstanding record of cost-efficient job creation:

- One new job has been created for every SBIC investment of $17,000.
- The government's actual cost to create a job through the SBIC program has been only $875 per job.

(We have recently completed an SBIC Job Creation Study which we are pleased to submit with our testimony for the record.)

The New SBIC Program Can Stimulate the Investment of Billions

Mr. Chairman, under your leadership, and the leadership of this Committee, Congress completely overhauled and improved the SBIC program in late 1992. SBA is now finalizing regulations to implement the new program.

All the evidence we have from the financial marketplace makes it very clear that this newly restructured SBIC program can be a major vehicle to provide long-term patient capital to new and emerging small business concerns.

- Hundreds of experienced, top quality venture groups are taking steps to form new SBICs, and

- Private institutional and individual investors are poised to invest hundreds of millions in private capital in the new program.

The level of interest in the new program is phenomenal. Based on our contacts in the financial markets, we believe the program will generate the following level of activity over the next five years:

- 150-200 new SBICs,

- These SBICs will have an average private capital of $10-20 million,

- Total private investment of $3.0 billion

- Total use of government guaranteed funding (leverage) of $3.0 billion.

- Total new investments in small business of $6.0 billion.

  - which will create 350,000 permanent new jobs.

Preconditions to Success

The new program will only be successful if it attracts top quality venture managers and the investment of a meaningful level of private capital. To achieve those objectives, two essential ingredients must be in place:

- The implementing regulations being developed by SBA must be workable and market-related, and

- Investors must have confidence that the government is committed to providing adequate funding for the program.

The Implementing Regulations

We have been working with SBA to develop workable regulations, and we are optimistic the final regulations will prove attractive to the venture and investment communities.

Regrettably, development of the regulations has taken longer than expected. It now seems realistic to expect final regulations to be published in October or November.

Recent Low Usage of Leverage

Because of this delay in putting the new regulations in place, the funds appropriated for the $75 million in guarantees of the new participating securities will not be used this year. Consequently, we agree with the decision of the SBA and the Committee to reprogram those funds to other SBA programs.

It is also true that SBICs have not used all of the funding available to them in the form of current-pay debentures over the past several years. Actual take-downs of leverage have been in the range of $60-$80 million per year. There are a series of explanations for this low usage level, many of which are related to the economy and existing market conditions. In any case, it has been appropriate to re-program those unused funds to program areas with high levels of demand.

Funding for Fiscal Year 1994

For 1994, however, we believe real demand for the program will begin to build. Once the new regulations are published, we believe new SBIC license applications will begin to pour in, with requests for funds occurring primarily in the latter half of the year.

For SBICs using the new participating securities, we estimate that during FY 1994:

- There will be 75-100 license applications, with an average private capital of $15 million.
- 30 new SBICs will be licensed, and will invest $150 million of their $450 million
- 15 new SBICs will take down and invest $150 million through preferred securities.

For SBICs using current-pay debentures, we estimate that during FY 1994:

- 15 new debt-oriented SBICs, having an average private capital of $5 million, will be licensed. During their initial year of operation these SBICs will invest $25 million of their private capital of $75 million.
- During this first year, 7 of these new SBICs will take down and invest $20 million of SBA-guaranteed leverage.
- In addition, existing SBICs will take down another $80 million of SBA-guaranteed leverage which will be invested in small concerns.

<u>Our Funding Request</u>

To meet these anticipated levels of demand for the first year, we believe the 1994 budget authority for the SBIC program should be at the following levels:

	Guaranty Authority	Subsidy Rate	Appropriation
	$150 mm in preferred securities	14%	$21.0 million
	$100 mm in current-pay debentures	15.39%	$15.4 million
Totals	$250 mm		$36.4 million

This level of funding is substantially less than the FY 1994 SBIC guaranty authority authorized in the Small Business Equity Enhancement Act of 1992 and represents only $10.6 million more than the Administration's budget request. But the increase is critical to show investors that the government's commitment to the new SBIC program is real.

Data generated from job creation studies of SBIC portfolio companies demonstrates that this government investment of $36.4 million in the SBIC program in FY 1994 will create 25,000 new, permanent jobs.

1994 is a Pivotal Year

The SBIC industry is highly sensitive to the need for the Federal budget as a whole to be reduced. This sensitivity has caused us to recommend the absolute minimum dollars we believe are necessary to attract the private investment dollars which are critically important to the SBIC program and which, in turn, are invested by SBICs in rapidly growing, job creating small businesses.

Adequate funding in the first year of the revitalized program is critical to generating credibility for the program among investors. We are aware of over 350 investment firms who have expressed strong interest in forming SBICs. If the first year funding is perceived as inadequate, these high quality, experienced investment groups will drop their plans to raise private capital to invest in small companies and move on to other investment strategies. Once lost, these groups will be very difficult to re-attract to the SBIC program.

In this environment of Federal budget deficits and a slow economy the Federal government needs to focus on supporting and building programs that create the greatest number of permanent jobs for the lowest possible cost.

The SBIC program meets these requirements.

Conclusion

Thank you for the opportunity to testify today. Obviously, this subject is of vital importance to the future of the SBIC industry and its continued ability to provide patient, long-term capital to small growing companies.

JOB CREATION
THROUGH SBIC INVESTMENTS IN SMALL BUSINESS

Executive Summary

President Clinton and Congress have a unique opportunity to create over 350,000 new, permanent jobs by supporting a low-cost, high-visibility investment initiative which will provide growth capital to emerging small businesses.

- Small Business, Jobs and the Need for Capital. Small growth firms are the primary engine of job creation in the U.S. economy. These emerging firms have extremely limited access to the patient, long-term capital they need for growth and expansion.

- SBIC Investments Create Jobs. The government has a venture capital program to solve this problem - the SBIC program administered by SBA. SBICs invest in small firms with high rates of growth and job creation. The $9.1 billion SBICs have invested in over 83,000 small business concerns since 1958 have produced an outstanding record of cost-efficient job creation:

  - One new job is created for every SBIC investment of $17,000.

  - The government's actual cost to create a new job through the SBIC program has been only $875 per job.

- The New SBIC Program. Congress completely restructured the SBIC program in late 1992. SBA is now finalizing regulations to implement the new program. Private investors are poised to invest hundreds of millions of private capital into new SBICs. It's a major new enterprise in the making. One hurdle remains - adequate government funding.

- A High-Visibility, Low-Cost Investment Initiative. This new SBIC program can be a fresh, high-visibility initiative to showcase the government's commitment to small business, job creation and investment in America's future. And, it can be launched with a modest government investment.

- Modest Initial Funding. For FY 1994, appropriations of only $30-million are needed to launch the start-up of this initiative. This will generate investments of $425-million in small growth firms ($175-million of private investments in SBICs coupled with $250-million in SBA-guaranteed funds). These investments will create 25,000 new jobs.

- Long-Term Impact. Over the next five years, appropriations of $347 million will fully fund the $3.0-billion for SBIC guarantees authorized by Congress, which will be coupled with another $3.0-billion of private capital. This $6.0-billion of SBIC investments in small growth firms will create over 350,000 permanent new jobs.

May, 1993

Job Creation and SBICs

A fundamental precept of President Clinton's economic recovery program is investment initiatives to create jobs

> *" . . the only way to lay the foundation for renewed American prosperity is to spur investment. New investment will create jobs, putting people back to work today, and will provide the productive equipment that we need to compete in the global economy."*
>
> President William J. Clinton
> *A Vision of Change for America*
> February 17, 1993

Introduction

Small businesses have traditionally been the engine of economic growth. These companies comprise over 95% of all businesses in the United States. Small Business Investment Companies (SBICs) provide small businesses with capital, strategic advice and management assistance in order to enable these small companies to grow and to enhance their likelihood of long term success.

The Small Business Investment Company program was established in 1958 to help fill the "equity capital gap", which Congress considered a serious threat to the vitality of our free enterprise economy. This program created a partnership between the federal government and the private sector to substantially improve the flow of long-term, risk capital to small businesses.

Under the program, the U.S. Small Business Administration (SBA) licenses private sector corporations and partnerships to provide financing and management assistance to small businesses in the U.S. Long term debt guaranteed by SBA (leverage) is made available to SBICs to supplement the private capital they raise, increasing the pool of funds SBICs can invest in small business. An SBIC's private capital is exposed to one hundred percent of any potential loss prior to any risk of loss to the federally guaranteed debt.

The SBIC program has been highly successful in meeting its objective of stimulating economic growth and creating jobs over the past three decades. This growth has been accomplished through SBIC investments of $9.1 billion in over 83,300 small business concerns. These SBIC financings have resulted in the creation of a substantial number of permanent jobs during the 35 year history of the SBIC program at a very low per job cost to the federal government.

Job Creation by Small Business

Small business is the greatest generator of new jobs in the U.S., and SBIC-backed companies are the most rapidly growing small firms in this sector of the economy.

Historically, the number of new jobs created by small businesses significantly exceeds the number of jobs created by large companies. In normal business cycles, small business creates 60-65% of all the new jobs created in the economy.[1]

Between 1987 and 1992, with the downsizing of many large American businesses, the job creation performance of small business was extraordinary. During this period small growth firms created 5.8 million net new jobs, while big business lost a net of over 2.3 million jobs. In short, over the last six years small business created all of the net new jobs in the U.S. economy.[2]

Accelerated Job Creation by SBIC-Backed Small Business

Within this context, SBIC-backed small businesses have even greater, proven job creation performance than small businesses generally. A Deloitte, Haskins and Sells (Deloitte & Touche) study[3] concluded that companies financed by SBICs have generated more than ten times the employment growth of all other small businesses. This is a result of the fact that SBICs intentionally invest primarily in startups and other small companies expected to have high growth rates.

Most importantly, the study found that SBIC-backed companies are unusually efficient engines of job creation. One permanent job was created with every $6,463 of funds invested by an SBIC. Adjusted for inflation, this would translate into one permanent job created for every $17,000 invested by SBICs today.

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1 *The State of Small Business: A Report of the President* (1986-90 editions). Other similar studies include: A Federal Trade Commission analysis for the period of 1969 through 1976, showing no new net jobs were created by the Fortune 1,000 companies; and a study by Massachusetts Institute of Technology that showed of 5.6 million companies surveyed two thirds of the net new jobs created between 1969 and 1976 were created by small, growth oriented firms. See also, *The Facts About Small Business*, SBA (April, 1993)

2 *Who's Creating Jobs?*, Cogenetics, Inc. (May, 1993). See also *The State of Small Business: A Report of the President* (1992)

3 "Summary of the Economic Impact of the Small Business Investment Company Program" by Deloitte Haskins & Sells, 1980. This study surveyed the job growth realized by all companies financed by SBICs from 1958 to 1979 compared to job growth by all small companies as reported by a combination of the Federal Trade Commission Quarterly Report of Manufacturing Companies, U.S. Bureau of Census, and Arthur D. Little, Inc. estimates. In addition to job growth, the study compared the average annual growth of all sales, profits, assets and federal corporate taxes among small businesses to those of SBIC financed businesses. Throughout the period measured, SBIC financed businesses demonstrated a superior growth rate in all categories studies compared to that of all other small businesses.

Support for these conclusions can also be found in a recent economic impact study completed by Coopers & Lybrand for the National Venture Capital Association[4] . The study found that 428 venture capital (and SBIC) financed companies created a net increase of 92,500 highly skilled U.S. jobs between 1985 and 1991, an average of 216 new jobs per company. The average net job growth increase per company was 18% compared to a net decrease of 2% for Fortune 500 companies over the same period.

Low Government Cost of SBIC Job Creation

Definitive studies have also demonstrated the low governmental cost of creating a permanent job through the SBIC program. The Deloitte & Touche Study concluded that $17,000[5] invested by an SBIC into a small business creates one permanent new job.

In order to determine the actual direct governmental cost of this new job, it is necessary to compute the government's actual per dollar cost of its share of this $17,000 investment . Over the past ten years the average outstanding amount of SBA guaranteed leverage was $847 million. During the same period the average outstanding amount of private capital invested in SBICs totaled $1.490 billion. The resulting average ratio of SBA guaranteed leverage to private capital is .568 to 1. At this ratio (56.8 cents for every $1.568 invested), the government share (represented by government guaranteed leverage) of each SBIC dollar invested in a small firm is 36%. Consequently, for each $17,000 invested by an SBIC to create a job, the government's share ($17,000 x 36%) is $6,120.

Historically, the government's actual cost for each $1 of SBIC leverage guaranteed by SBA has been 14.29 cents (or 14.29%)[6]. Therefore, the government's $6,120 share of the amount an SBIC invests to create a job multiplied by the government's per dollar cost of 14.29% produces a historical government cost to create a new job through the SBIC program of $875 per job. This level of cost is significantly below the published per job cost of most other job creation programs sponsored by the Federal government.

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4 "Third Annual Economic Impact of Venture Capital Study" by Coopers and Lybrand and Venture Economics.
5 $6,463 cost per job in 1980 adjusted for inflation to the present.
6 Office of Management and Budget (OMB) budget scoring model for the SBIC program, 1992.

Recent Evidence of Low-Cost Job Creation by SBICs

A recent study of a representative group of SBIC portfolio company investments confirmed the remarkable job creation capacity of SBIC investments in small growth firms.[7] The study covered SBIC investments of $544 million in 442 small growth firms over the last ten years.

During this period, these small businesses created a net increase of 49,678 new jobs for the U.S. economy. The creation of each new job, therefore, involved an SBIC investment of only $11,000. (While this is substantially less than the $17,000 investment per job used in the above analysis, we have chosen to use the more conservative figure to compute the government cost per job.)

An Efficient, High-Visibility Investment Initiative

In today's environment of budget deficits government investment initiatives designed to create jobs must be highly efficient and produce the greatest numbers of permanent jobs at the lowest cost.

The SBIC program has a thirty-five year history of creating permanent jobs at extraordinarily low cost to the government. Despite the compelling low cost job creation success of the SBIC program, utilization of the SBIC program was de-emphasized substantially during the past ten years. The number of operating SBICs was also sharply reduced during this period.

In order to revitalize the SBIC program and thereby benefit from this efficient engine of job growth, Congress passed legislation in late 1992 to restructure and improve the program (the Small Business Equity Enhancement Act of 1992, P.L.102-366). With the regulations governing this exciting new program nearly complete, numerous institutional and other private investors are poised to invest millions of dollars into new SBICs.

The new SBIC program can be a fresh, high-visibility initiative to showcase President Clinton's commitment to small business, job creation and investment in America's future growth.

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[7] NASBIC survey of thirteen randomly selected SBICs of different sizes, from various geographic locations and having different investment strategies (May, 1993).

Conclusion

The SBIC program alone can go a long way to help the President meet his job creation goals. And, it can be launched with a modest investment of government funds.

Appropriations of only $354-million over five years would fully fund the entire $3.0-billion in SBIC guarantees authorized by Congress. Based on the proven job generation capability of the SBIC program, this level of funding would ultimately create over 350,000 permanent new jobs.

For FY 1994, the SBIC industry is requesting an appropriation of $36.4 million.[8] This level of funding will create 25,000 new jobs, and it represents a modest increase of $10.6-million over the Administration's request for SBIC funding.

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[8] $21-million to support SBA guarantees for $150-million of participating securities at a subsidy rate of 14%; and $15.4-million to support SBA guarantees of $100-million for current pay debentures at a subsidy rate of 15.4%.

Association of Small Business Development Centers®

The Small Business Development Center (SBDC) Program:

a national resource for America's small businesses

Presentation

to the

House Small Business Committee

Chairman: Congressman John J. LaFalce

Thursday, May 27, 1993

Presented by:

Janet Steele Holloway, President

National Association of Small Business Development Centers
and
State Director, Kentucky Small Business Development Center

Mr. Chairman, members of the Committee, distinguished guests: I'm pleased to have this opportunity to present to you some background, as well as some of the impact and economic results, of the national Small Business Development Center (SBDC) program.

But first, I would like to thank you, Chairman LaFalce, and your colleague Congressman Neal Smith for your continued support of this program. Your leadership and support of the SBDC program over the years has enabled nearly three and one- half million aspiring and established entrepreneurs to have access to valued information, education and advice about starting, growing, and managing successful businesses that contribute to the economic stability of families and communities across this country. Your recent support of the SBDC program and your willingness to communicate such to a new administration demonstrated how serious and dedicated your commitment is to the small business community. On behalf of those working in the SBDC program and the millions of small businesses who've benefitted from SBDC services, I thank you.

In 1977, as you may well be aware, the U.S. Small Business Administration funded a pilot program at nine universities across the country — University of Georgia, California StatePolytechnic University, California State University, The University of Southern Maine, The University of Missouri, The University of Nebraska at Omaha, Rutgers University in New Jersey, The University of West Florida, and Howard University in Washington, D.C. These nine schools were

chosen to particpate in the University Business Development Center (UBDC) program because they already had in place business assistance services or programs.

The success and impact of these programs was evident, and in July 1980, Congress passed Public Law 96.302—the Small Business Development Center Act—thus establishing the national SBDC program. Since 1980, the SBDC program has grown dramatically from 10 SBDCs and an annual budget of $4,000,000, to 56 "lead center" SBDC programs with 946 service center locations in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands and a FY93 annual appropriation of $67,000,000. Not only Congress, but state and local governments across the country have embraced this program by providing well over the cash match required and by including the SBDC program in their overall economic development plans.

In October 1990 the sunset provision on the SBDC program was removed, making the SBDC a permanent program. Regulations were written jointly with the Small Business Administration in 1992 and were submitted to Congress by the SBA Administrator.

SBDC Counseling

Since 1977, SBDCs have provided free, direct counseling to over 1,257,040 aspiring and established entrepreneurs. (See Appendix B) In 1992, for example, SBDCs counseled 222,497 businesses. Of these, 40.8% were service businesses; 20.6% were retail operations; 11% were manufacturers;

5.7% were wholesalers; and 3.9% were in construction. Counseling addressed such issues as marketing and market research, finance, management, credit and collections, accounting and bookeeping, business valuation, capital formation, business planning, and start-up or pre-venture assistance. Of these 222,497 businesses using SBDC counseling services:

30.5% were women;
11.2% were veterans;
13.1% were Afro-Americans;
6.3% were of Hispanic origin;

and 4.1% were Native American, Asian or Pacific Islander.

SBDC Training

Since 1977, nearly two and one-half million people have attended SBDC training programs. (See Appendix B) In 1992 over 13,000 SBDC training programs were attended by over 319,535 small business owners and managers, of whom:

43.% were women;
14.% were minorities;
8.7% were veterans.

Through networks of colleges and universities, SBDCs are able to access special assistance services for businesses with special needs, including those in technology and manufacturing. Most SBDCs provide businesses with counseling assistance and training programs related to international trade, technology transfer, procurement, rural development, and small business innovation research.

(GIVE CASE STUDY EXAMPLE)

Economic Impact

The Small Business Development Center voluntarily began measuring economic impact of SBDC services in 1987 by looking at the increase in sales, job creation, and new revenue generation by 1985 SBDC "long-term" clients—that is, those receiving 12 or more hours of counseling. Each year, SBDC clients show remarkable growth in these areas, compared to businesses not receiving SBDC services.

For example, a national study measuring SBDC clients' progress between 1988 and 1989 showed:

- an estimated $2.9 billion in increased sales;
- the creation of almost 15,000 new jobs; and
- over $110 million in increased tax revenues.

The results of this survey, conducted by the University of Houston, were resoundingly positive. All of the participating states reported overall growth in client sales from 1988 to 1989 (See Appendix A, chart 1). As would be expected, growth was generally much higher for start-up respondents, many of whom had only niminal sales their first year. Aggregating the data, growth in sales was 22% for existing businesses and 209% for start-ups.

Almost all respondents experienced growth in full and part- time employment (See Appendix A, chart 2). Growth in employment for existing businesses was 16% full-time and 11% part-time while employment growth for start-ups was 53% full- time and 82% part-time.

For SBDC clients responding to the survey, a gain in tax revenues was estimated to exceed $23.9 million; extrapolating to the entire SBDC client population, those counseled would have contributed an additional $110.8 million to state and federal coffers—nearly twice the amount of federal dollars invested in the program. This impact is very impressive when compared with the overall cost of counseling those clients. The increased federal and state revenues from respondents alone surpassed the cost of counseling all long-term clients. It is estimated that federal and state revenues generated by long-term SBDC clients were 18 times greater than the cost of their counseling.

Additional factors to consider are the hidden benefits, which are difficult to measure, if at all. How many businesses, business owners and families were

saved from bankruptcy? How many creditors were saved from uncollectible debts? All because the SBDC consultant advised clients to get more information before making major business decisions, advised them not to go into a business, or to close a business which couldn't be saved!

General Accounting Office Review

An attached summary (Appendix C) of a 1989 GAO Report demonstrates that most clients counseled by the SBDC program indicated:

- satisfaction with the SBDC assistance received;
- they would use SBDC program services again if they had similar needs in the future; and
- they would recommend the program to others.

SBDC Partnerships & Funding Formula

Small Business Development Centers represent a partnership between universities and colleges, state and local government, economic development resources, chambers of commerce, and the federal government. Local and state non- federal dollars provide the matching funds to secure federal support. SBDC federal funds are provided through a formula that caps a state's federal assistance to $200,000 plus its ratio of the U.S. population times $75 million. At present, the SBDC program is considerably "overmatched" with non- federal dollars and the vast majority of states have indicated strong interest in expanding the program if additional, matching federal dollars were available.

Demand for SBDC Services

The demand for SBDC services continues to grow as more and more citizens make use of this national resource. The downsizing of many corporations has resulted in a surge of demand from those wishing to start a second career in small business. Women entering business in record numbers account for 30% - 40% of the SBDC client base and the demand from this sector is growing. HR820, which passed the House last week and supports technology development and extension, will generate increased demand for companion business development assistance as new technology and processes are introduced in the manufacturing sector.

Most people hear of SBDC services from local referral resources such as banks andchambers of commerce or from another small business owner, a friend, or someone who has attended SBDC sponsored training programs. SBDCs seldom, if ever, advertise their services via newspaper ads, media or public service announcements, for, if we did, the demand would be overwhelming! The result of this, of course, is that many aspiring entrepreneurs and established business owners are not aware of the services in their region and are not utilizing resources that could strengthen their operations and increase their competitiveness.

Given the proven positive results of the SBDC program, I think you would agree that more people should have access to business development services that can help us maintain and create thousands of new jobs, build stronger

economies, and enable businesses to become and remain more competitive in local, regional and global markets. Small business is at the cutting edge of job creation today and the SBDC program can make an even greater contribtution to America's economy if the program were expanded.

I would like to propose, therefore, that this Committee consider the value of the SBDC program and increase the authorization level of the SBDC program to a minimum of $150 million. Such an increase would accomplish several objectives: one, it will provide a strong incentive for states to increase their investment in this program; two, it will allow for expansion of SBDC programs to increase market penetration; three, it will ensure that America's small businesses in all sectors have the business development expertise needed to become and remain competitive; and finally, it will result in more jobs, stronger businesses, and more vitalized communities across America.

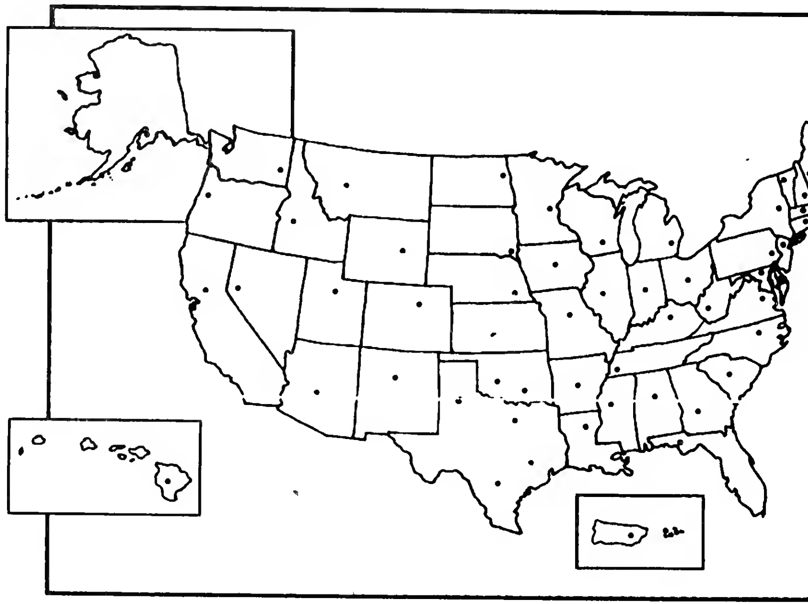
I recognize, Mr. Chairman, that additional monies are hard to come by these days, but we know that where there is a will, there is always a way! There is a strong and serious need to encourage business growth and expansion that will result in job creation and I am convinced that the Small Business Development Center program will contribute to that economic goal.

Thank you, Mr. Chairman, for your consideration of these issues.

ASBDC

Association of
Small Business
Development Centers

A national resource for America's small businesses



APPENDIX A

CHART 1

Changes in Sales

Generated by 1988/1989 SBDC Clients

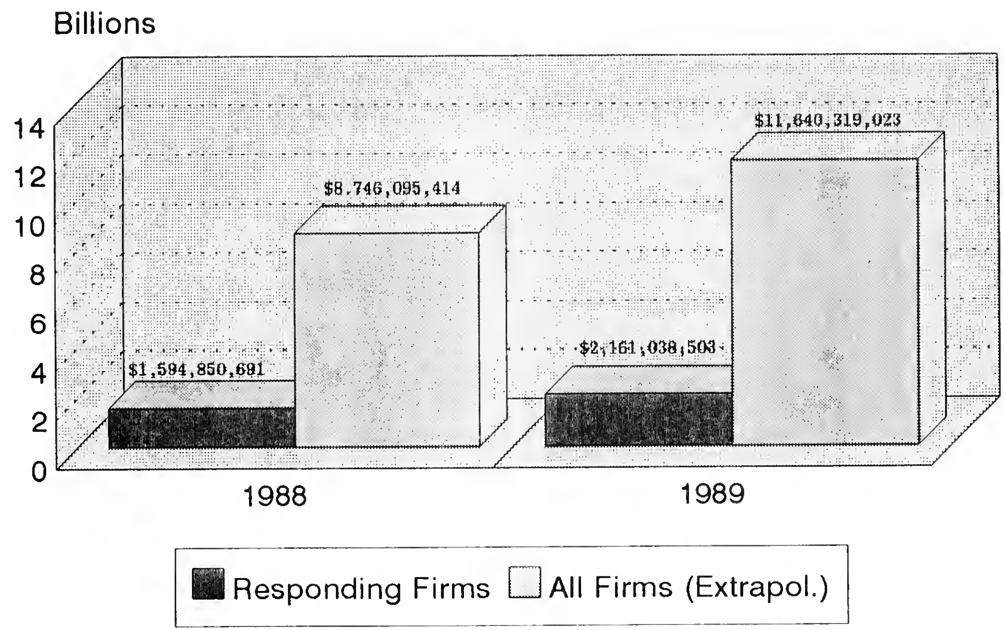
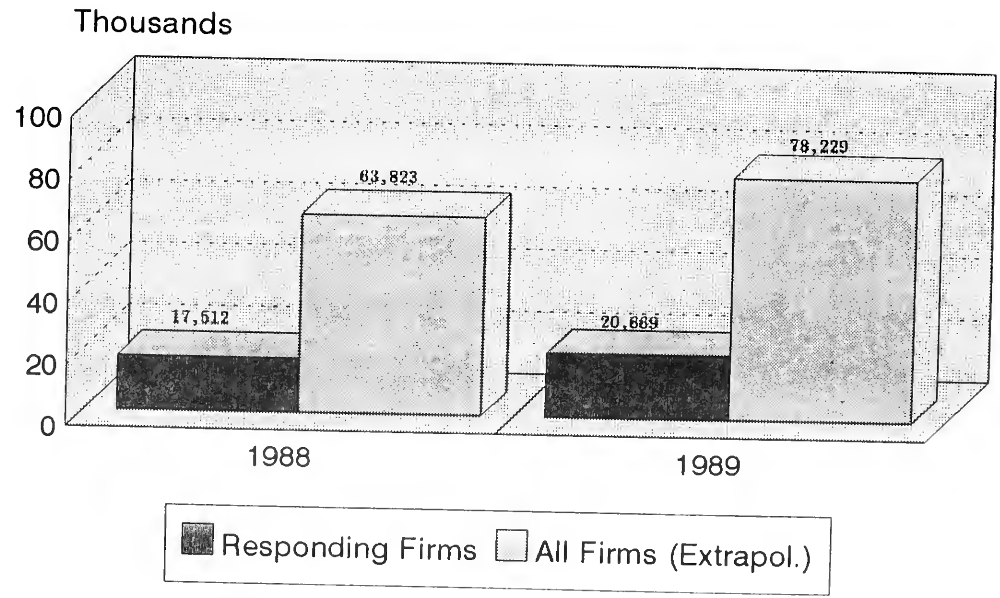


CHART 2

Changes in Employment

Generated by 1988/1989 SBDC Clients

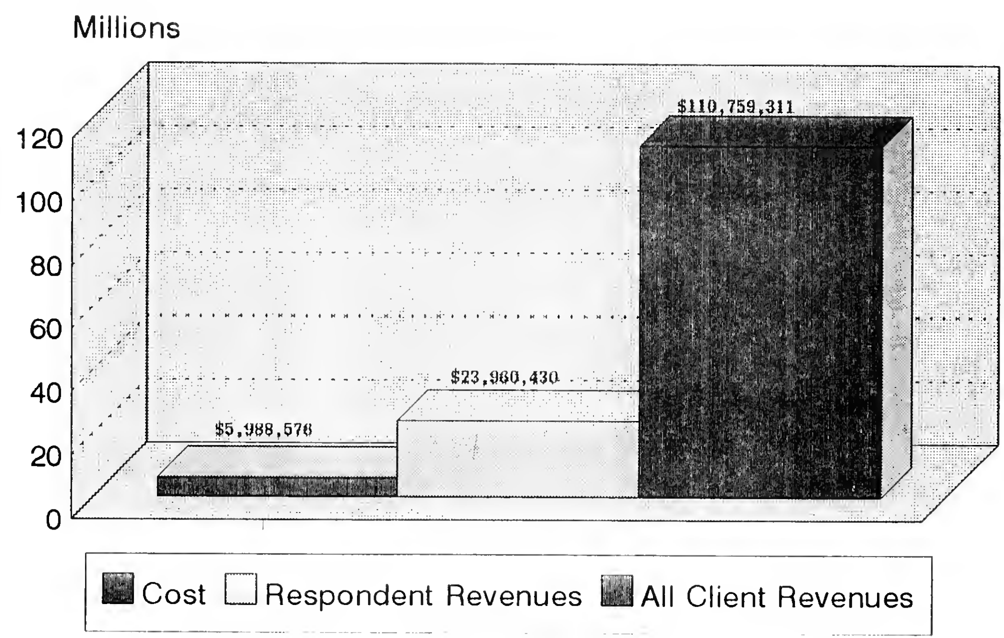


(includes full and part-time employees)

CHART 3

Counseling Cost/Tax Revenue

By 1988 SBDC Long-Term Clients



APPENDIX B

U.S. SMALL BUSINESS ADMINISTRATION
SMALL BUSINESS DEVELOPMENT CENTER PROGRAM

Fiscal Year	Clients Counseled	Training Attendees
1977	2,000	30,000
1978	2,600	34,000
1979	3,000	37,500
1980	17,482	36,618
1981	14,202	40,381
1982	24,025	54,594
1983	43,506	94,019
1984	50,115	102,384
1985	66,745	182,417
1986	72,153	258,991
1987	56,034	219,638
1988	128,514	248,298
1989	171,700	283,257
1990	191,865	274,437
1991	190,602	279,534
1992	222,497	319,535
Grand Totals:	1,257,040	2,495,603

Source: U.S. Small Business Administration
Office of Business Development
Fiscal Year Historical Data

APPENDIX C

1989 GAO REPORT

GAO

United States General Accounting Office

Briefing Report to the Chairman, Committee on Small Business, U. S. Senate

November 1989

SMALL BUSINESS

Development Centers Meet Counseling Needs of Most Clients

GAO/RCED-90-38BR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-209790

November 22, 1989

The Honorable Dale Bumpers
Chairman, Committee on Small Business
United States Senate

Dear Mr. Chairman:

As requested in your letter and in subsequent discussions with your office, this briefing report provides information on the Small Business Development Center (SBDC) program. This program is administered by the Small Business Administration (SBA) and, unless reauthorized by the Congress, will expire on October 1, 1990. The SBDC program, started in 1977, provides business-related counseling, training, and specialized support assistance to the small business community. The program is implemented at the state and local level through a nationwide network of 53 Small Business Development Centers and 534 Subcenters as of April 1989. (Section 1 provides a more detailed description of the program.)

Specifically, this report provides nationwide information on

- client satisfaction with program assistance,
- sources of program funding,
- services provided by the program,
- clients' characteristics and minority participation,
- staff characteristics, and
- usefulness of on-site reviews of the program.

Information on client counseling came from responses to questionnaires sent to a projectable sample of 997 counseled clients. Information on program operations, including general characteristics, staffing, funding, and administration came from responses to questionnaires sent to all center and subcenter directors responsible for implementing the program at the state and local level. (Section 2 provides a more detailed description of our objectives, scope, and methodology.)

In summary, we found that most clients counseled by the SBDC program reported that they were satisfied with the assistance they received. In addition, most would use SBDC program services again if they had similar needs in the future and would recommend the program to others. To improve program administration and operation, SBA has initiated action

to determine the feasibility of a multiyear grant approval process. We believe this change would benefit the program. Additionally, SBA is conducting on-site reviews at centers. We believe these reviews are useful to both SBA and center directors.

Clients Satisfied With Program Assistance

Overall, 69 percent of clients were satisfied with the counseling they received. Similarly, 76 percent indicated they would contact the program for future help if needed, and 82 percent would recommend the SBDC program to others. SBDC clients also said they were assisted quickly, received the kind and amount of assistance they wanted, and found the assistance useful. About 17 percent of clients counseled by the program were not satisfied with the assistance they received. Dissatisfied clients believed they were not assisted quickly and did not receive the kind and amount of assistance they wanted, and they reported that the assistance received was not useful. Few of these dissatisfied clients indicated they would use the program in the future or recommend it to others. About 14 percent of those counseled by the program were neither satisfied nor dissatisfied with the assistance they received. (Section 3 contains more information on client satisfaction with the program.)

Sources of Program Funding

Centers received federal grants from SBA to operate the SBDC program and provided an equal matching amount from nonfederal sources. Federal funding for the program increased annually from $360,000 in 1977 for 9 centers to $45 million in 1989 for 53 centers. Of the 53 centers receiving funding in 1989, 28 had reached their maximum federal funding limit. (See app. II.) In addition, states' contributions to the program have been increasing. (See app. III.) To reduce centers' annual administrative burden associated with applying for funds, SBA is looking into the feasibility of using a multiyear grant approval process. (Section 4 contains a detailed description of program funding.)

Program Services Emphasize Counseling

SBDC centers and subcenters provide a variety of services to clients but emphasize counseling. Client counseling was provided most frequently by program staff and less frequently by private sector consultants. Most centers coordinated their activities with other organizations and programs that address small business needs. (Section 5 provides detailed information on the services provided by SBDC centers and subcenters.)

Characteristics of Clients Counseled

Clients who received SBDC counseling were most frequently male, white. and 31 to 40 years old. Most had some college experience or a college degree. Most clients were in or planned to be in the retail or service sector. Few clients wanted or received assistance in obtaining government contracts. Of those who received this assistance, about a third were minorities. (Section 6 provides data on the characteristics of clients.)

Characteristics of Center and Subcenter Staff

Centers and subcenters employ professional and support staff on both a full-time and part-time basis. The average number of staff was 20 for centers and 5 for subcenters. Center and subcenter directors were most often male, white, and 31 to 50 years old. Most had attained a professional or graduate degree and had several years prior experience in business-related activities, with the most frequent type of experience being private industry employment. (Section 7 provides data on the characteristics of center and subcenter staff.)

On-Site Reviews Are Useful

SBA is required by law to carry out on-site reviews of each center every 2 years. SBA, the Association of Small Business Development Centers, and center directors reported some benefits from on-site reviews. At a minimum, they are providing SBA with program data not otherwise available and are providing a forum for the exchange of ideas between program directors. (Section 8 contains a description of on-site reviews and their usefulness.)

We discussed the report's contents with SBA program officials and have incorporated their comments where appropriate. However, as requested we did not obtain official comments on this briefing report from the Administrator, Small Business Administration.

Unless you publicly announce its contents earlier, we plan no further distribution of this briefing report until 30 days from the date of this letter. At that time, we will send copies to interested congressional committees and to the Administrator, Small Business Administration. We will also make copies available to others upon request.

If you have additional questions or if we can be of further assistance on this issue, please contact me at (202) 275-5525. Other major contributors to this briefing report are listed in appendix V.

Sincerely yours,

John M. Ols, Jr.

John M. Ols, Jr.
Director, Housing and
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APPENDIX D

ASBDC MEMBERSHIP DIRECTORY

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ASBDC Membership Directory, April 1993

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Holloway

A national resource for America's small businesses

ASBDC

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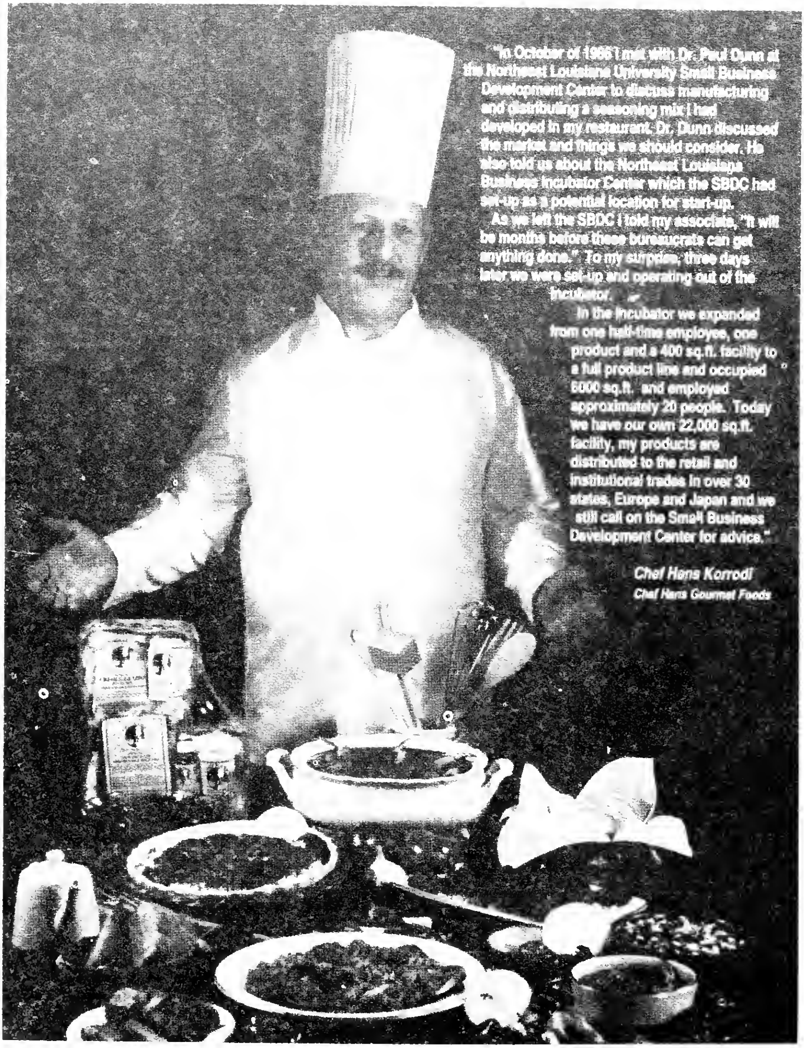

"In October of 1986 I met with Dr. Paul Dunn at the Northeast Louisiana University Small Business Development Center to discuss manufacturing and distributing a seasoning mix I had developed in my restaurant. Dr. Dunn discussed the market and things we should consider. He also told us about the Northeast Louisiana Business Incubator Center which the SBDC had set-up as a potential location for start-up.
As we left the SBDC I told my associate, "It will be months before these bureaucrats can get anything done." To my surprise, three days later we were set-up and operating out of the incubator.
In the incubator we expanded from one half-time employee, one product and a 400 sq.ft. facility to a full product line and occupied 6000 sq.ft. and employed approximately 20 people. Today we have our own 22,000 sq.ft. facility, my products are distributed to the retail and institutional trades in over 30 states, Europe and Japan and we still call on the Small Business Development Center for advice."
Chef Hans Korrodi
Chef Hans Gourmet Foods

SBDC Mission

Major economic and political changes are transforming the world we live in. Far-reaching trade alliances, the dissolution of major communist block influences, the downsizing of our defense activities, and rapid changes in American industry size and trends—all resulting in a more competitive, global economy here at home.

America's economy is dependent on the vitality and strength of its small businesses. Small firms, able to respond quickly to market changes, create jobs and lead the way in the development of new technologies.

Entrepreneurs are visionaries—men and women who look toward the future to make their dreams a reality. The job of the SBDC network is to help them see all the possibilities and to offer them the tools and information they need to get the job done. By providing counseling, training and research assistance in the start-up, successful operation and expansion of small businesses and by facilitating export and technology development and transfer, SBDCs strengthen business and economic development in every region and state in the U.S., Puerto Rico and the Virgin Islands.

Benefits and Impact

The SBDC program nationwide has had a positive impact on the nation's economy with over 3 million people utilizing SBDC resources. A University of Houston study in 1991 indicated that: ***sales growth*** of SBDC clients served during 1988 ***averaged 209 percent*** for pre-venture or start-up clients and ***22 percent*** for non-pre-venture clients served by the SBDC network. ***Growth in full-time employment was 53 percent*** for pre-venture clients and ***16 percent*** for non-pre-venture clients.

The ***U.S. General Accounting Office*** found that 92 percent of SBDC clients made business-related decisions subsequent to contact with the program. Nearly 70 percent of the clients who made business decisions believed that their experience with the SBDC program affected their decisions in a positive way. Sixty-nine percent of SBDC clients reported overall satisfaction with SBDC services.

The Business of Helping Small Business

When an SBDC representative comes to work, he/she may find himself/herself spending the day on an asphalt go-cart track, in a fashion boutique, planning a new restaurant, or on the plant floor. Such was the case at the South Central Small Business Development Center in Somerset, Kentucky, an office administered by Eastern Kentucky University since 1987.

Fun Country of Somerset, a family-owned amusement center asked for help in designing a business plan and to offer some suggestions on marketing. The owners, a mother-daughter team of Marlene Morgan and Tresa Merrick, opened Fun Country in May of 1989.

Morgan says she and her daughter always wanted to be in a service business, helping people. And, given the large number of tourists in the area, an amusement center naturally suggested itself. But when the SBDC representative came to visit the business, he couldn't find it, Morgan said. She learned that, "If the customers can't find you, that's not good. We found we had a serious marketing problem."

"This is the first business anyone in our family has ever owned," says Morgan. "The prospect of starting a business can be intimidating, and we've made expensive mistakes." But they've learned quickly, not only from mistakes but from good decisions.

SBDC helped her develop a marketing plan and search for ways to make the operation profitable year-round rather than just in the summer.


Victor Mondry, of Victor Allens Coffee and Tea is a retailer and distributor in Madison, Wisconsin: "If you're going to lead a business, you have to have a financial strategy to follow. The University of Wisconsin - Extension SBDC has helped me to define and refine the strategy that works."

ASBDC

Core Counseling Services:

Through one-on-one counseling services, Small Business Development Centers work with existing and aspiring small business owners within the following core service areas:

Feasibility Studies - an assessment of the individual's readiness and preparedness to start and support a business enterprise;

Needs Assessment - an analysis of the company's strengths, weaknesses and business opportunities;

Structuring a Business - a review of the appropriate structure for the type of enterprise: sole proprietorship, partnership, or corporation;

Market Research and Market Planning - a thorough consideration of the company's existing and potential markets and a plan for moving products/services to those markets;

Financial Analysis and Control - an evaluation of the company's past and present financial health and position;

Cash Flow Analysis and Financial Projections - a critical study of cash flow processes and business operations forecasting;

Debt and Equity Funding Development - a consideration of the company's financing requirements and opportunities;

Valuation of Business - broad application of important tools to determine value when buying or selling a business;

Strategic Planning - an extensive definition of the business owner's vision and methods for applying that vision to daily decision-making;

Accounting Systems - relevant and simple recordkeeping systems for managing the business;

Management Issues - a look at company policies and procedures, management style, human resource management and organization.

The Small Business Development Center counseling approach is one of guidance and education, not of completing the client's work for him or her. It's necessary that anyone requesting assistance must have a strong personal commitment to find and implement solutions to the issues facing that company.

Core Training Services

By leveraging the resources of professionals in business and industry, government, universities and professional associations, SBDCs offer—at nominal registration fees—a vast range of workshops, seminars, conferences and courses.

Training topics include,
but are not limited to:

Business Plan Preparation
Credit Management
Marketing
Financial Analysis
Home-based Business
Export Management
Customer Relations
Taxation Issues
Total Quality Management
Bidding on State and
Federal Government Contracts

Golden Limousine is owned and operated by Soteria Watkins, who commented, "I don't know where I would be today without the Greater Atlantic City SBDC...." Golden Limousine maintains contractual relationships with several Atlantic City casinos and has grown from three cars to over 80 various size vehicles to serve the Mid-Atlantic region.

Greg Frisby, CEO of Frisby Airborne Hydraulics of Long Island, New York, a family owned aerospace manufacturing company, credits the SBDC program with greatly facilitating their successful corporate turnaround. "Through technology transfer, export guidance and hands-on Total Quality Management (TQM) assistance, our local SBDCs have enabled us to refocus our efforts toward commercial and foreign markets, thereby redefining and rejuvenating our 50 year old business. The SBDC network is well-positioned and well-qualified to assist small businesses with their diversification efforts and expansion efforts."

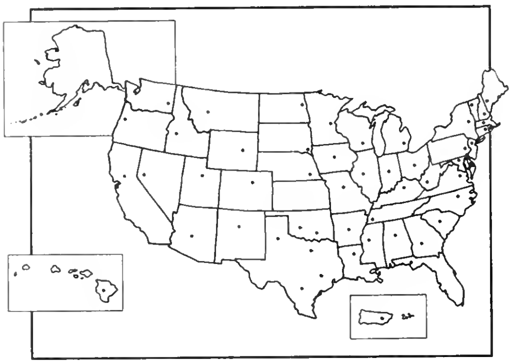
Mr. Frisby was recently appointed to the National SBDC Advisory Board.

Special SBDC Programs:

Manufacturing and
Technology Assistance
Technology Innovation
and Commercialization
Product Development
Export Assistance
Procurement Information and
Technical Assistance
Microcomputer Training
Rural Economic Development
Inventor Assistance
Disaster Assistance

The History of SBDC

Established in 1980 when Congress enacted Public Law 96.302, the Small Business Development Center program now includes a network of over 700 Small Business Development Centers in every state, the Virgin Islands and Puerto Rico. SBDCs provide a range of management assistance services and programs designed to help businesses keep pace in today's competitive world and to increase the stability, success, competitiveness and profitability of small enterprises.



Membership Services Office: 1313 Famam Street, Suite 132,
Omaha, Nebraska 68182
(402) 595-2387

"Small Business Development Centers (SBDCs) serve a very important need by providing basic information and counseling to persons considering starting a small business or expanding their operation. With the help of SBDC programs, many new enterprises have been launched, adding significantly to the economic base of numerous communities throughout the country."

John Galles, executive vice president
National Small Business United (NSBU)

"The Small Business Development Centers provide tremendous support to emerging and growing businesses. In particular, women-owned businesses benefit from the business counseling, educational workshops and conferences offered by the SBDC Centers.

"The National Association of Women Business Owners (NAWBO) has experienced a rich partnership with the SBDCs in many of our Chapter cities across the country Through collaboration and cooperation, many opportunities have become available to women business owners.

"We salute the efforts of these programs and look forward to developing new horizons for all small businesses through the SBDC programs and services nationwide."

Grace McGartland, president
(NAWBO)

"For many years, the Small Business Development Centers have served members of the 100 trade associations represented by the Small Business Legislative Council. The industries range from tool and die companies to dry cleaners to bus companies....I think this demonstrates the scope of business knowledge and skills that SBDC counselors and educators possess. I believe these industries have been strengthened by SBDC services, enabling many of them to survive and grow in a very competitive environment. The SBDC program is one of the most important and effective business extension programs in the country today."

John Satagaj, president
Small Business Legislative Council (SBLC)

"The SBDC has been involved with me from day one in starting and operating my several businesses. This entrepreneunal/small business and development 'process' is still going on and is in its eleventh year! I have included the SBDC as one of four key 'advisors', along with my CPA, attorney and banker. The SBDC's professional counsel and expertise has always helped us develop a positive direction toward a profitable and expanding business. We literally could not have done it without them."

Lee Borland, Chairman NFIB/NY;
President—Comsec Security & Fire Systems; Security Press Inc.

Each SBDC is a partnership between higher education, state government, the U.S. Small Business Administration, and the private sector and builds on the diversity and experience of each resource to benefit aspiring and established entrepreneurs.

Association of
Small Business
Development Centers

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